Premier's Council Task Force on Investment in Ontario

Canada in the Global Market Place:

Challenges and Opportunities

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Review of the Mandate of the Premier's Council Task Force on Investment in Ontario

The original mandate of the Premier's Council Task Force on Investment was to develop strategies and to propose actions to retain and attract investment for Ontario.

In the context of the evolving global world economy, this original mandate has proven to be too narrow in focus. We will demonstrate that, over and above retaining and attracting investment, there is a strong need:

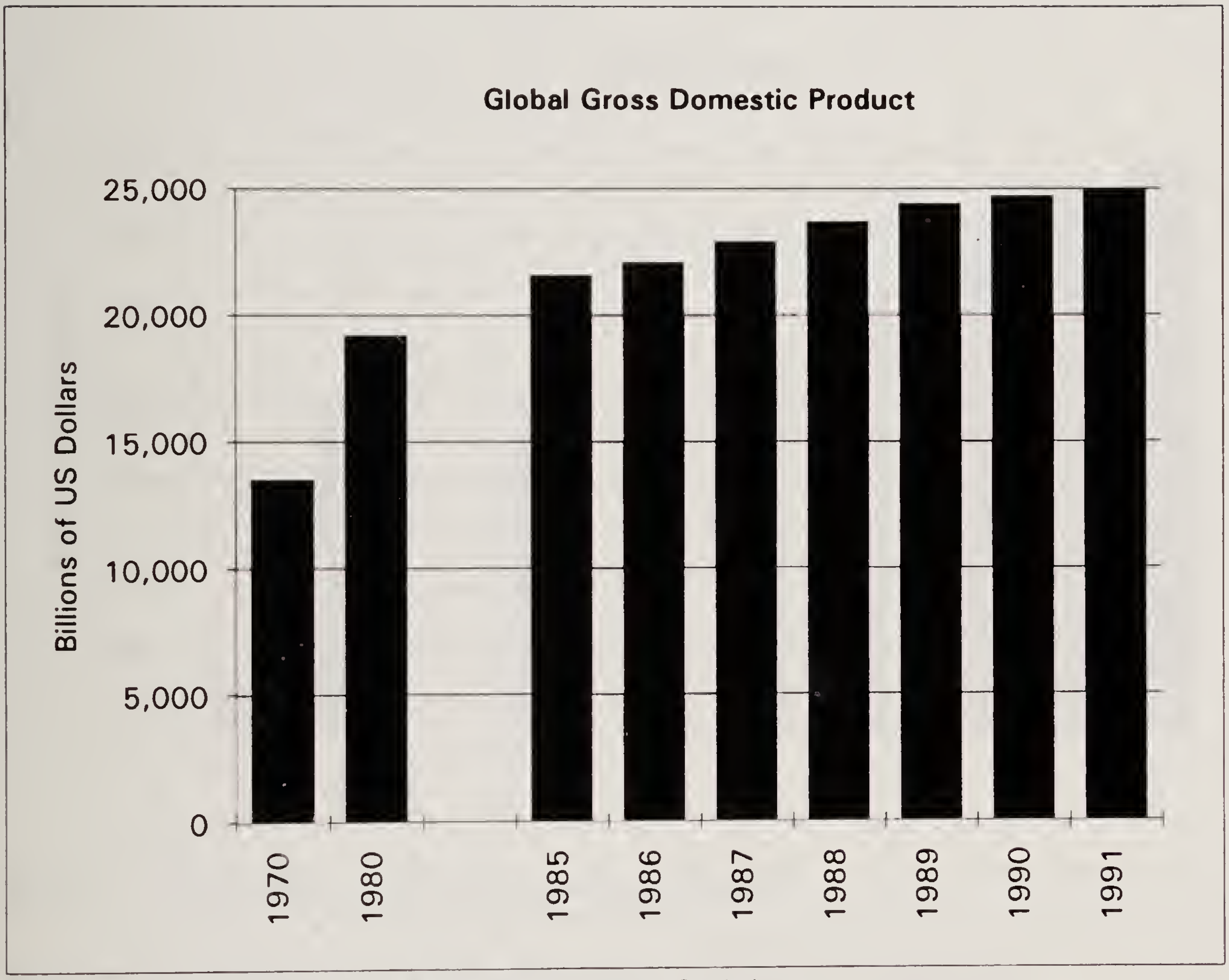
1) to internationalize firms based in Canada, both Canadian and foreign, thus enhancing Canada's competitiveness in the global market place, and,

2) to support and nurture the formation of Canadian investment.

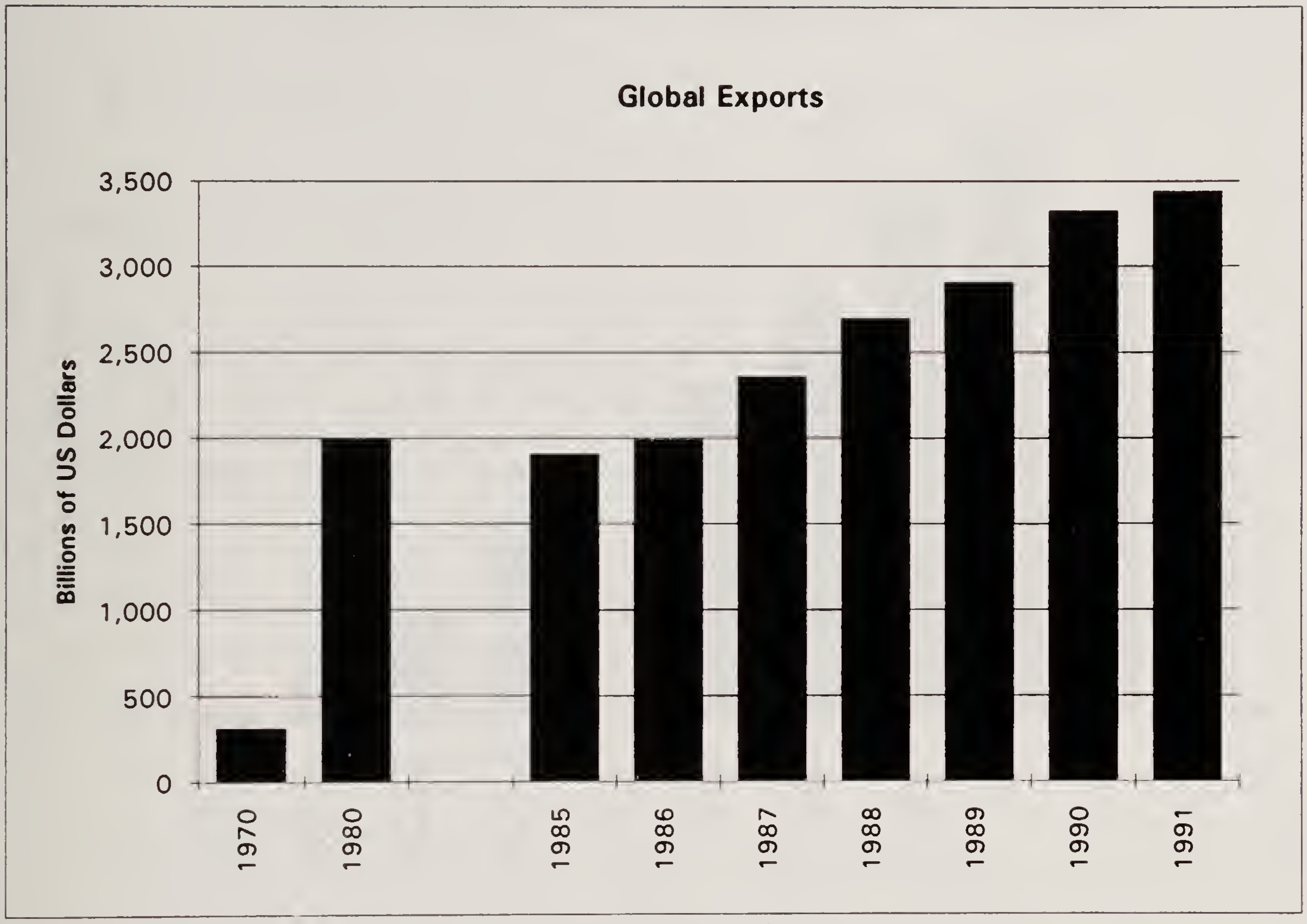
These findings are an extension of the former work performed by the Premier's Council Task force on investment in Ontario and of a more recently constituted working group on internalization within the Task Force on Investment.

The information is based on a series of reports published by the United Nations Conference on Trade and Development Programme on Transnational Corporations, Statistics Canada, and various statistics from US Government Agencies. United Nations' "World Investment Report 1993: Transnational Corporations and Integrated International Production"; New York, 1993, "World Investment Directory 1993: Asia and the Pacific", New York, 1992 and "World Investment Directory: Central and Eastern Europe", New York, 1992, were particularly useful.

Global Foreign Direct Investment Flows

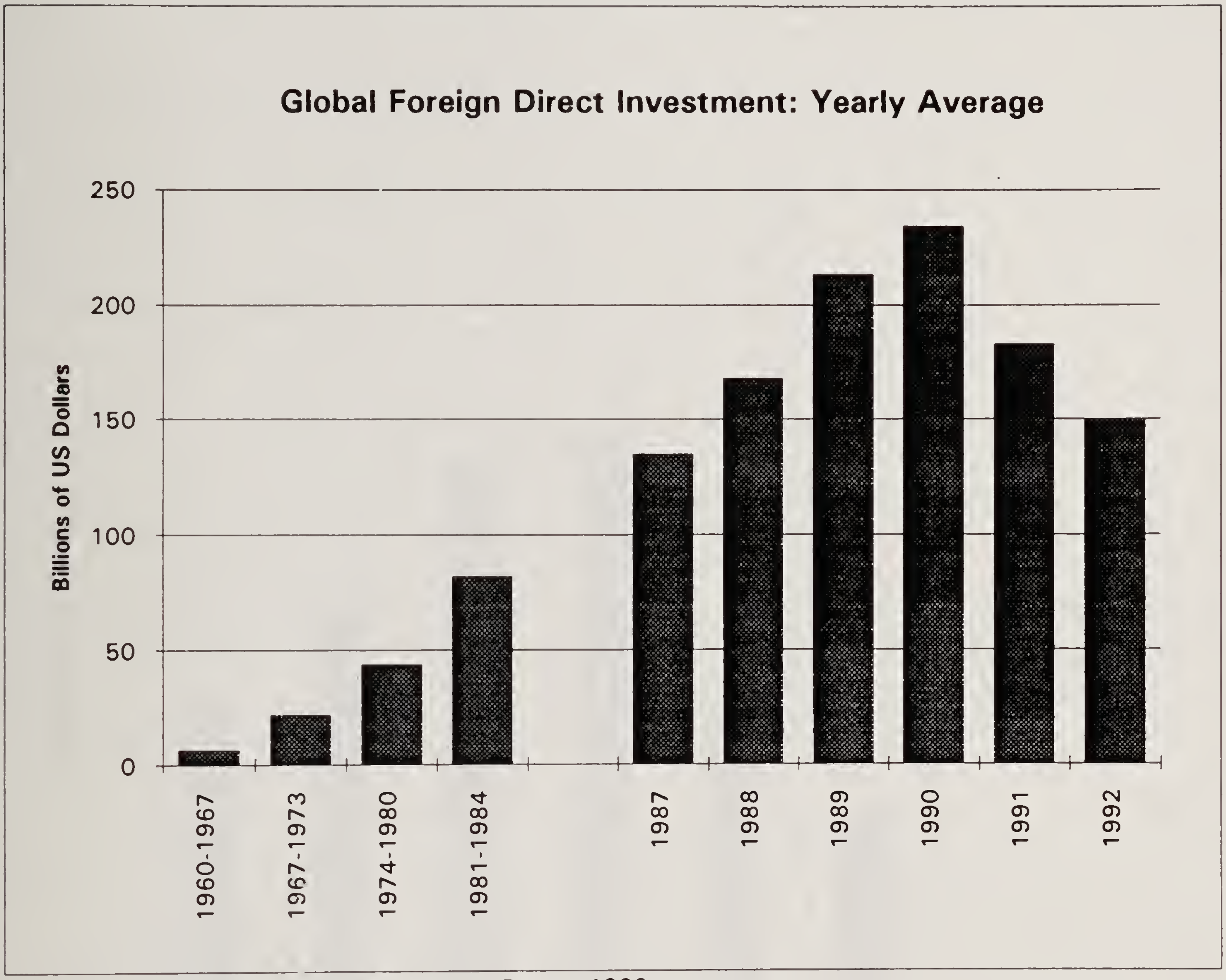


Source: CIA. Handbook of International Economic Statistics.



Source: CIA. Handbook of International Economic Statistics.

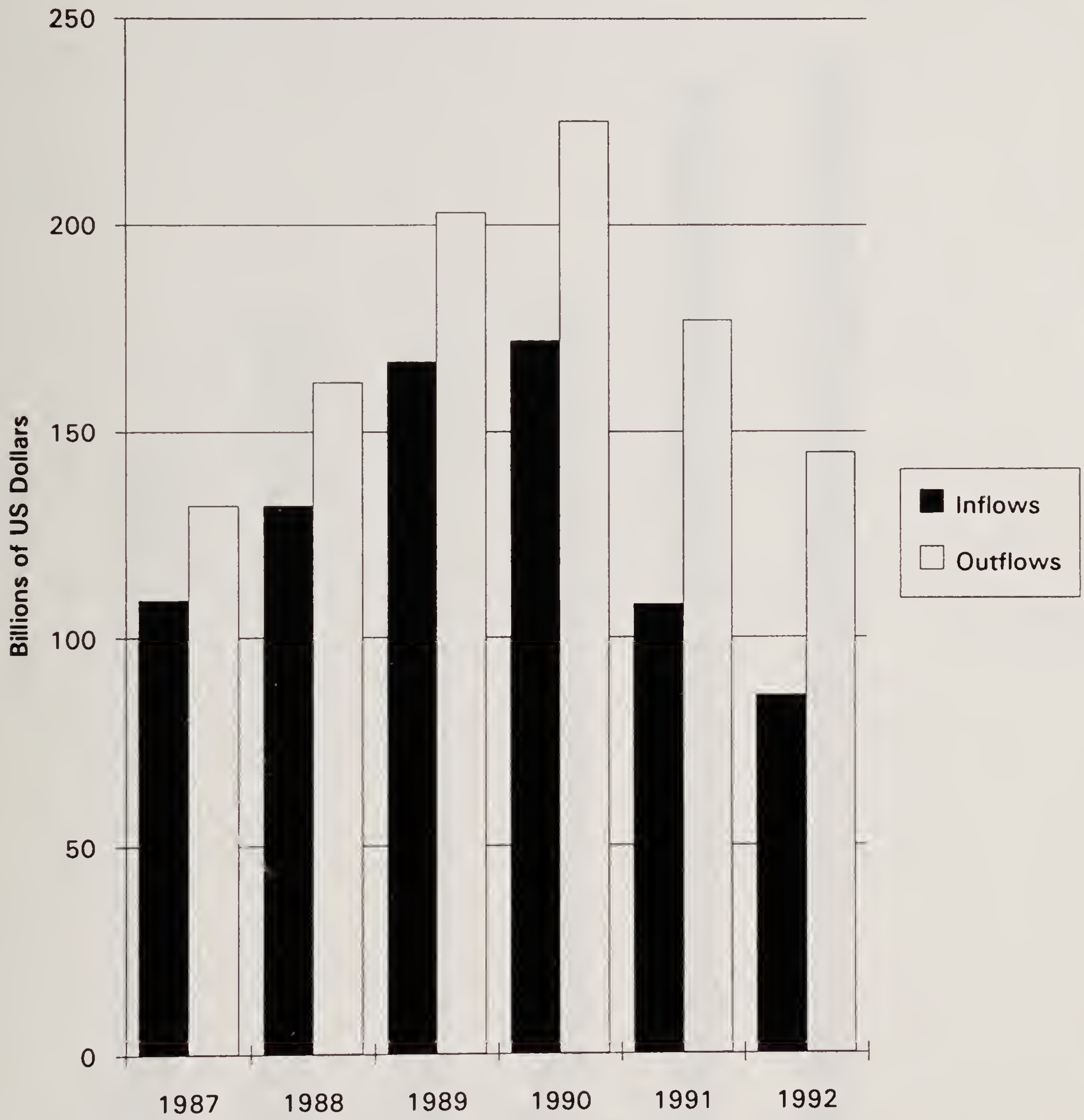
Since the mid 1980s, the growth in exports has been due to the growth in intra-firm transfers between transnational corporations. By 1992, fully one third of world exports is accounted for by intra-firm trade within transnational corporations.



Source: UNCTAD. World Investment Report, 1993.
U.S. Department of Commerce. International Direct Investment, 1984.

The estimated global stock of foreign direct investment in 1992 was $2 trillion, which generated $5.5 trillion dollars in sales by foreign affiliates. This compares with world exports of goods and non-factor services of $4 trillion, of which one third took the form of intra-firm trade.

Developed Countries: Foreign Direct Investment Inflows and Outflows



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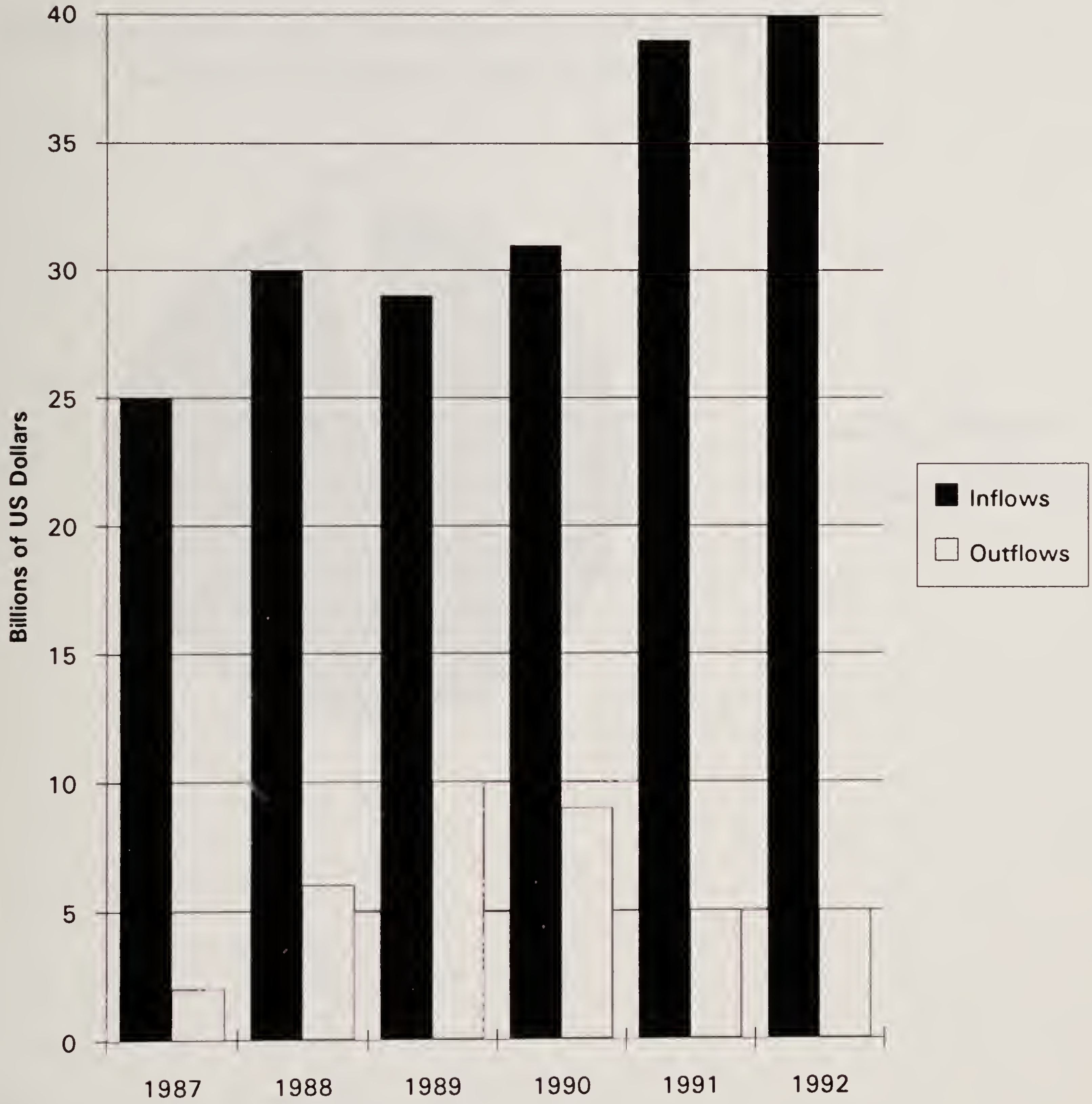
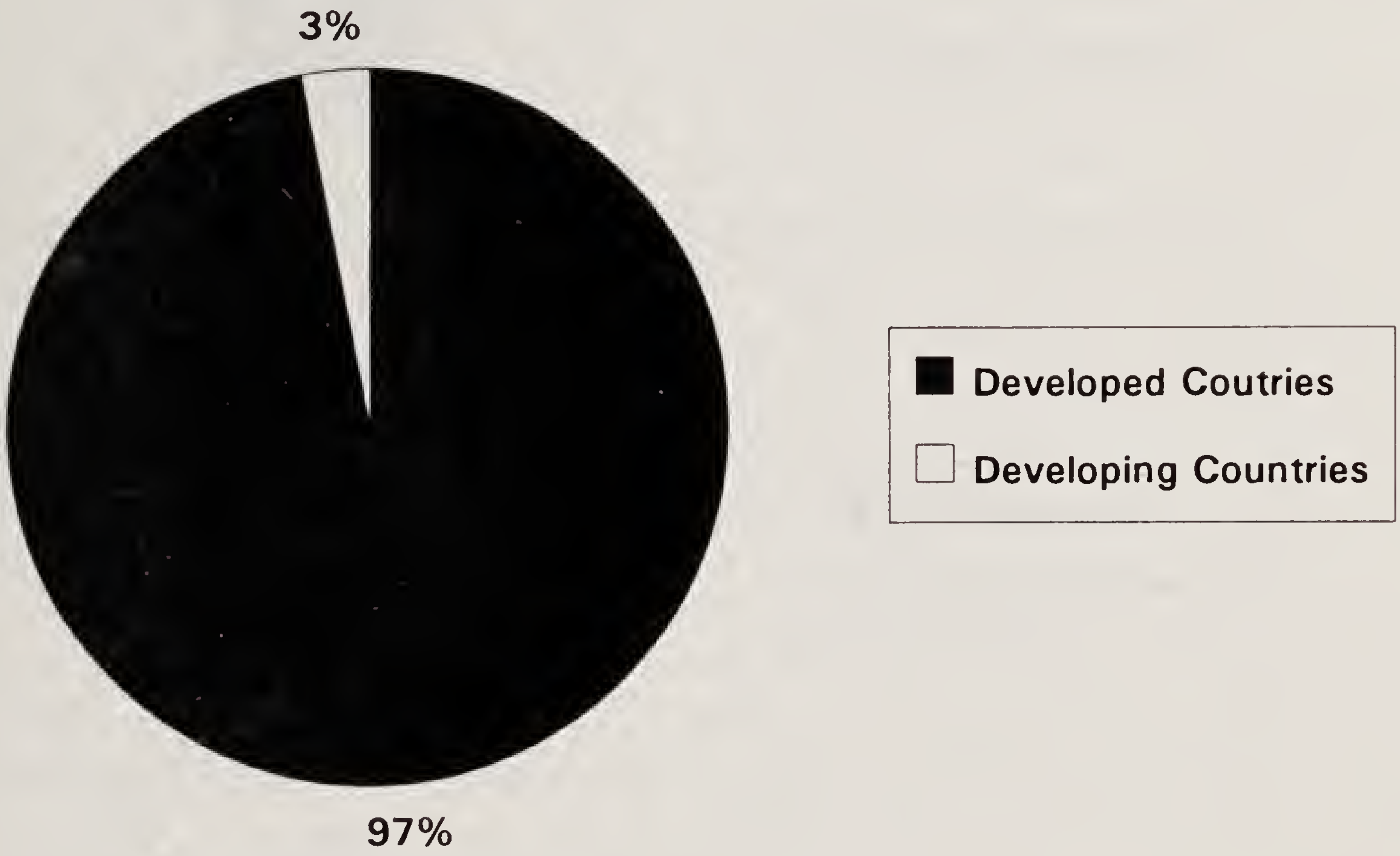
Developing Countries: Foreign Direct Investment Inflows and Outflows



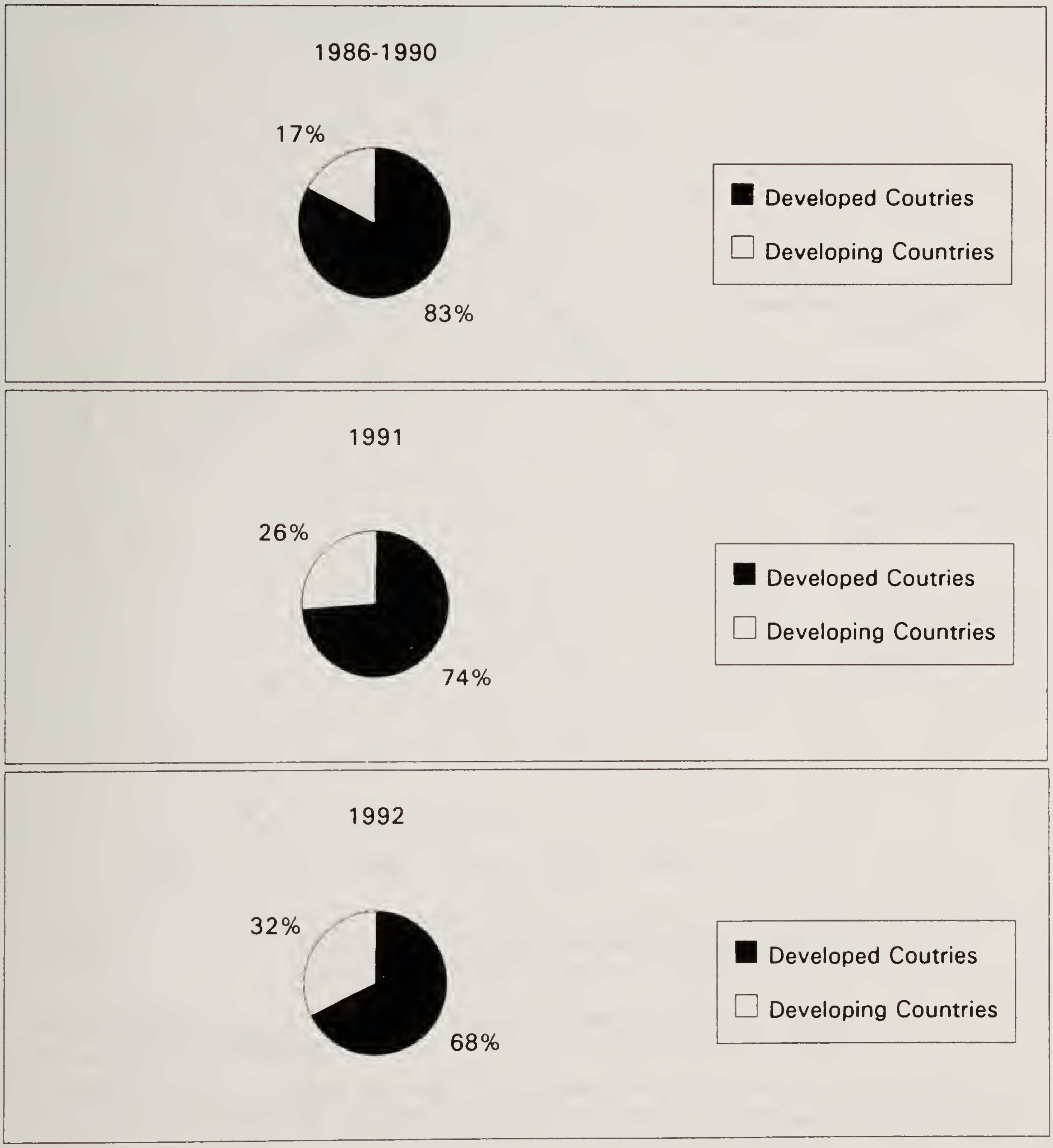
Source: UNCTAD. World Investment Report, 1993.

Outflows of FDI from Developed and Developing Countries: by Share, 1986-1992

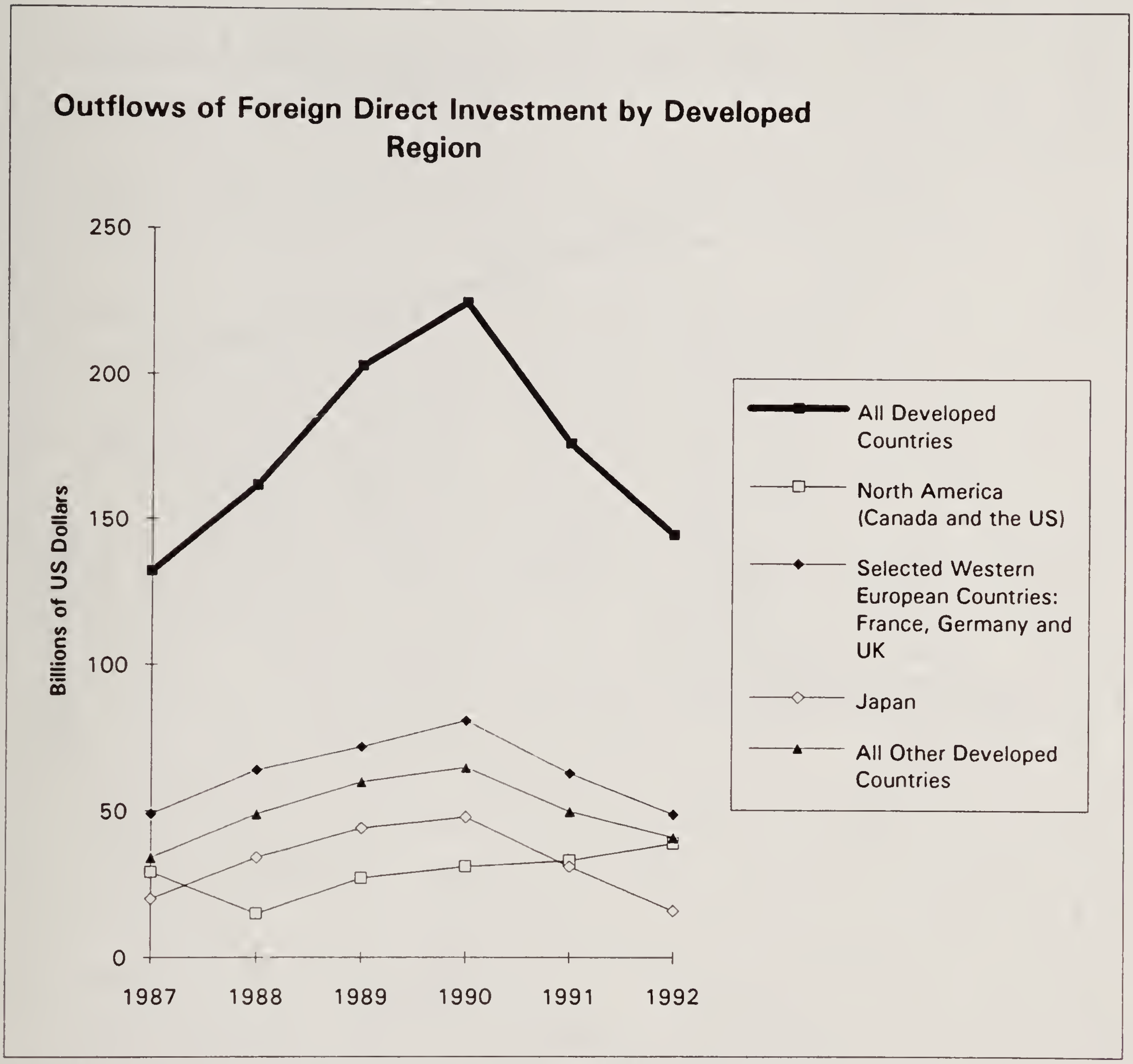


Source: UNCTAD. World Investment Report, 1993.

Inflows of Foreign Direct investment to Developed and Developing Countries: by Share, 1986-1992

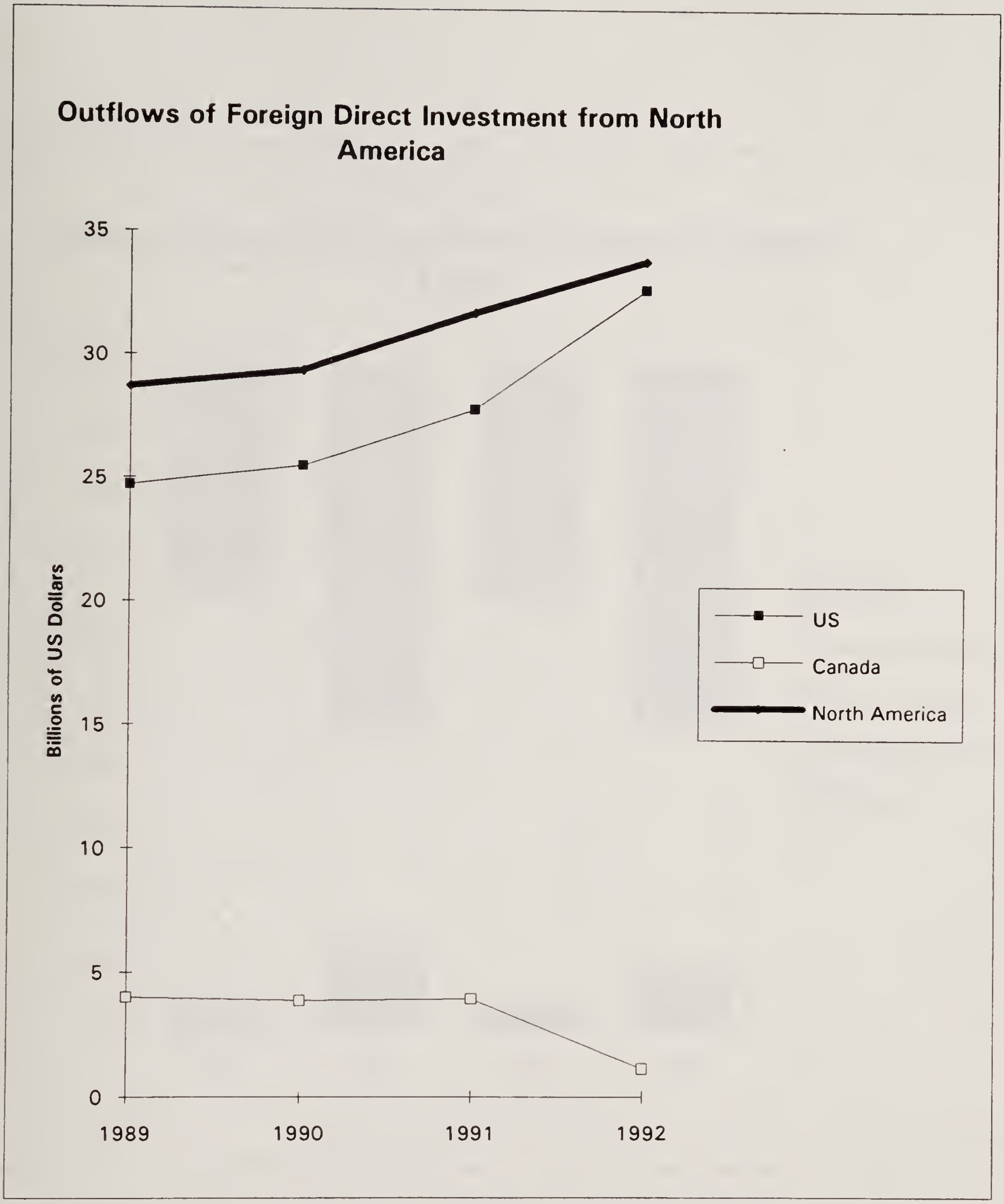


Source: UNCTAD. World Investment Report, 1993.



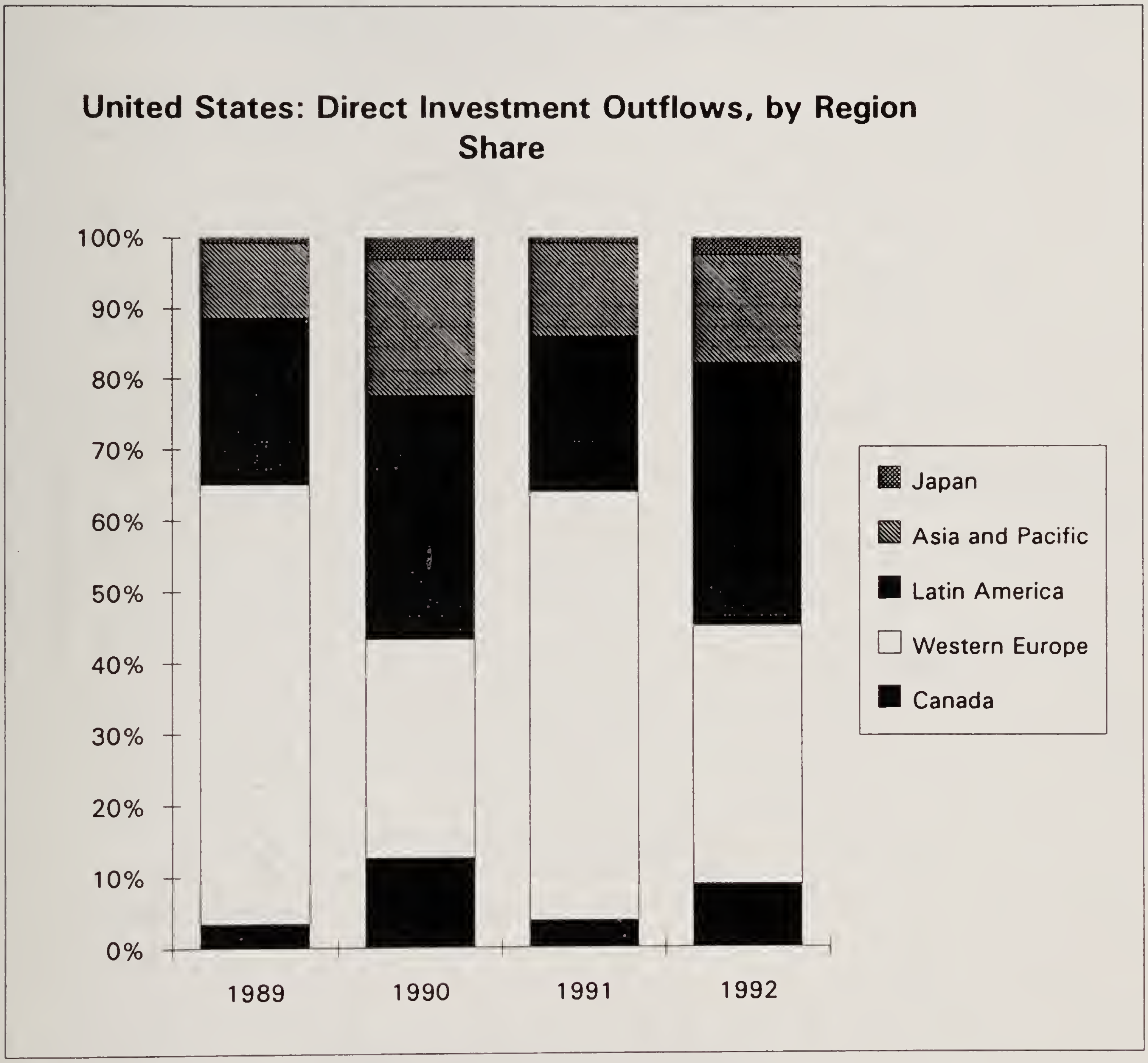
Sources: Canada: Statistics Canada: CANSIM: 2327 D 78056, March 1993
Others: UNCTAD. World Investment Report, 1993.

All other developed countries does not include North America, Japan, France Germany and UK.
While the outflows peaked in 1990, the US continued to invest abroad through to 1992. During the same period the outflows from the rest of the developed world declined.

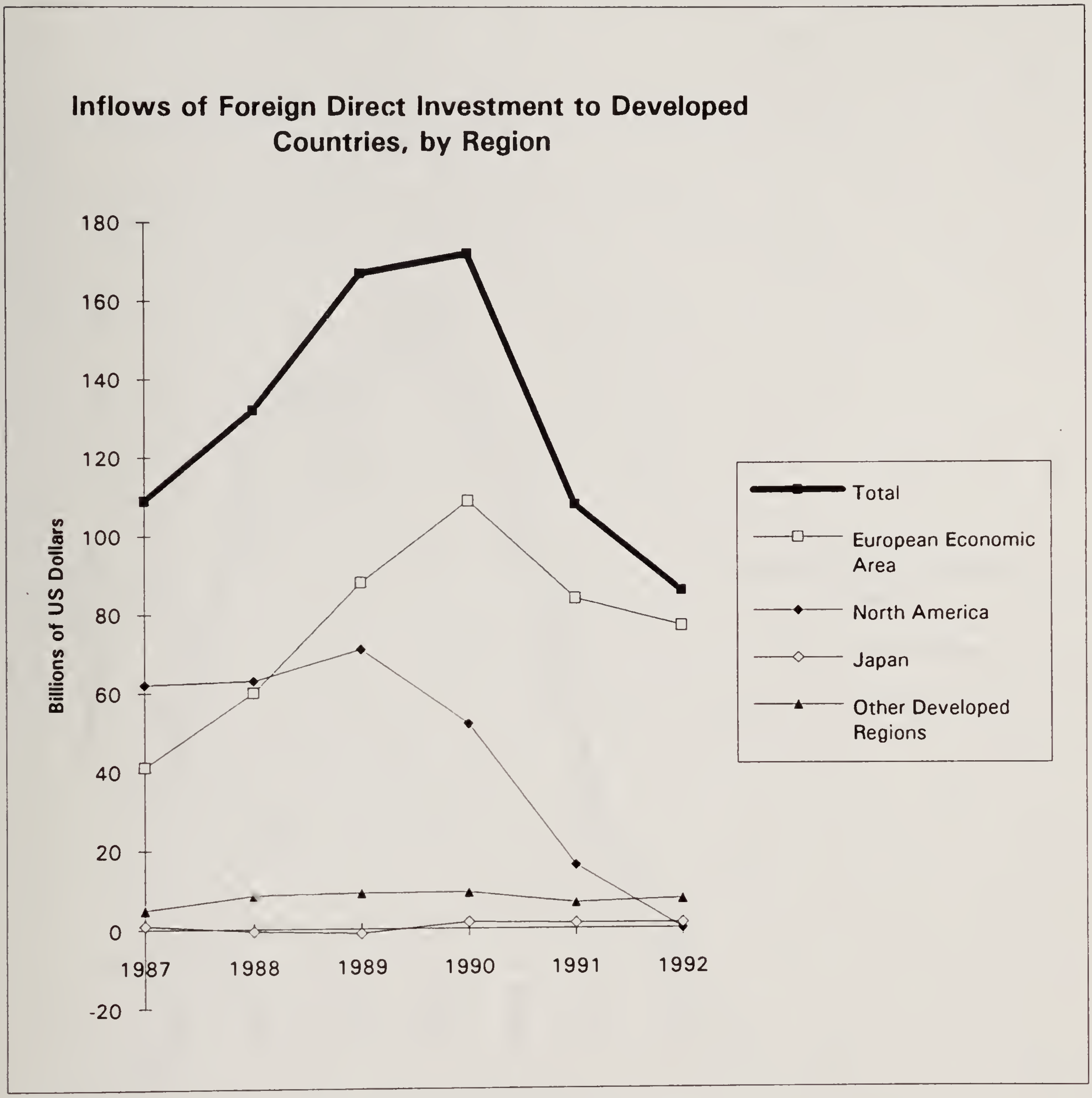


Sources: Statistics Canada. International Balance of Payments, 1993.
US Department of Commerce. Survey of Current Business, 1993.

Outflows do not include intra-regional flows.

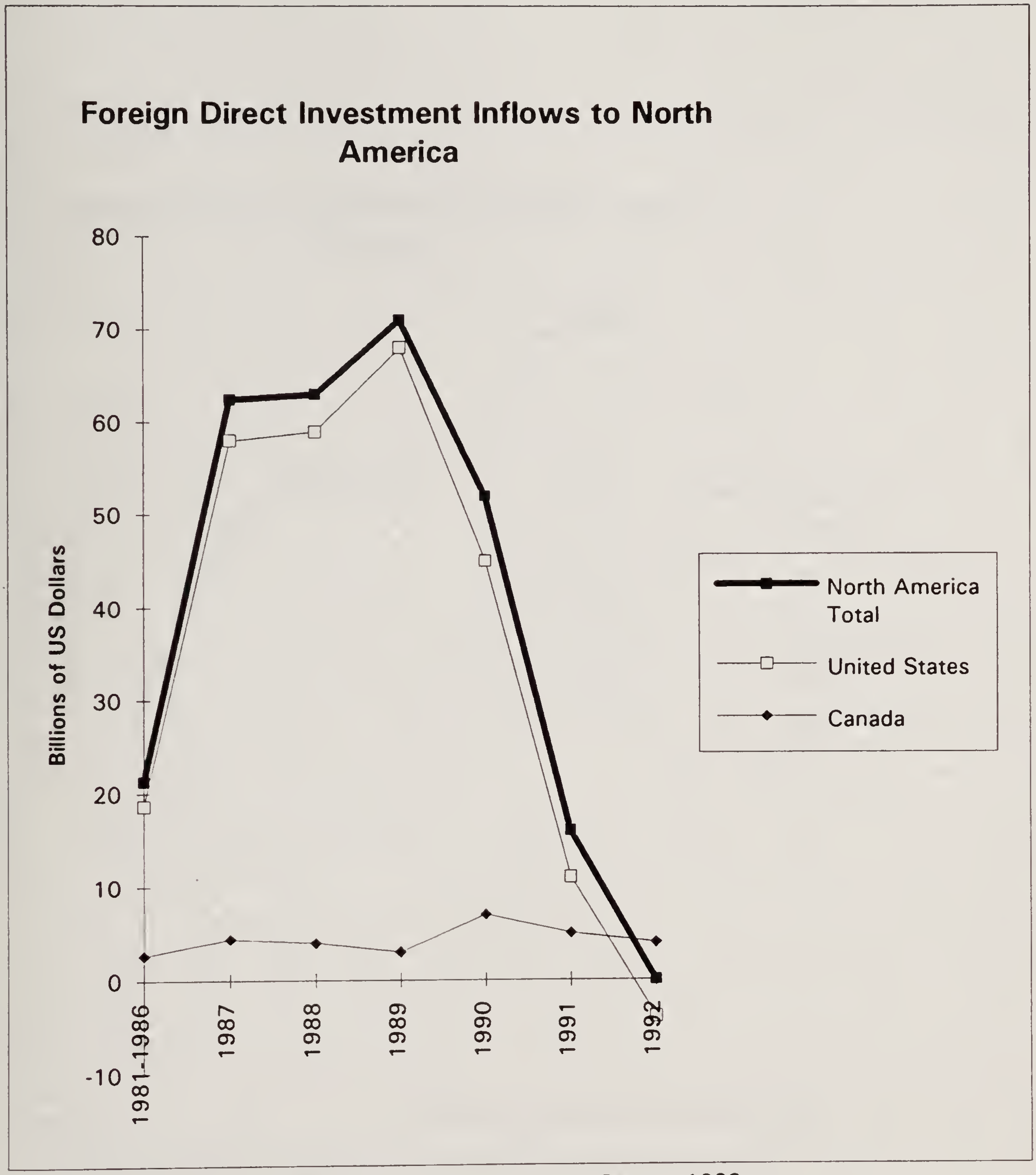


Source: US Department of Commerce. Survey of Current Business, July 1993



Source: UNCTAD, World Investment Report, 1993

The European Economic Area includes European Community and EFTA.
North America includes the Unites States and Canada.



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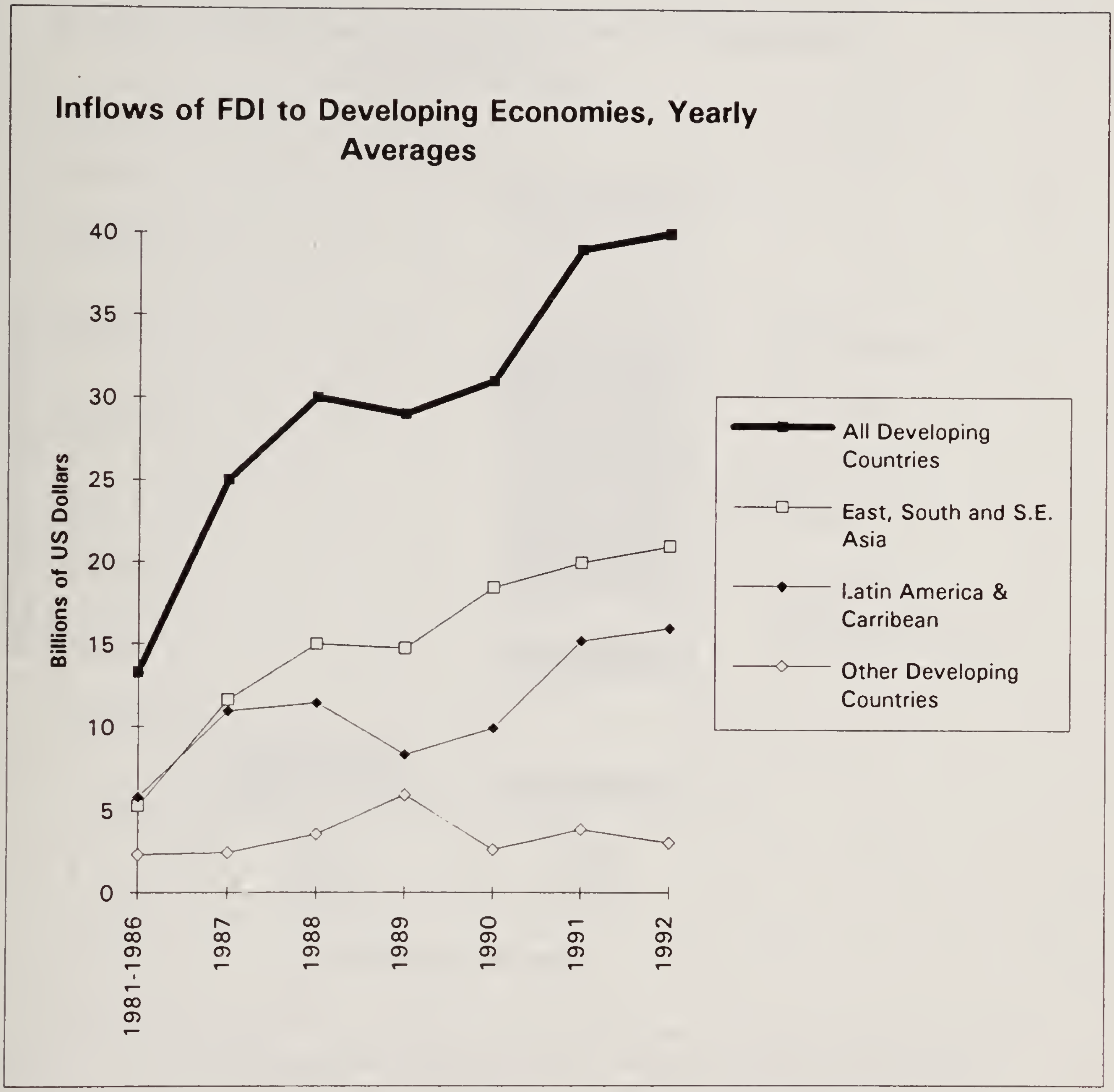
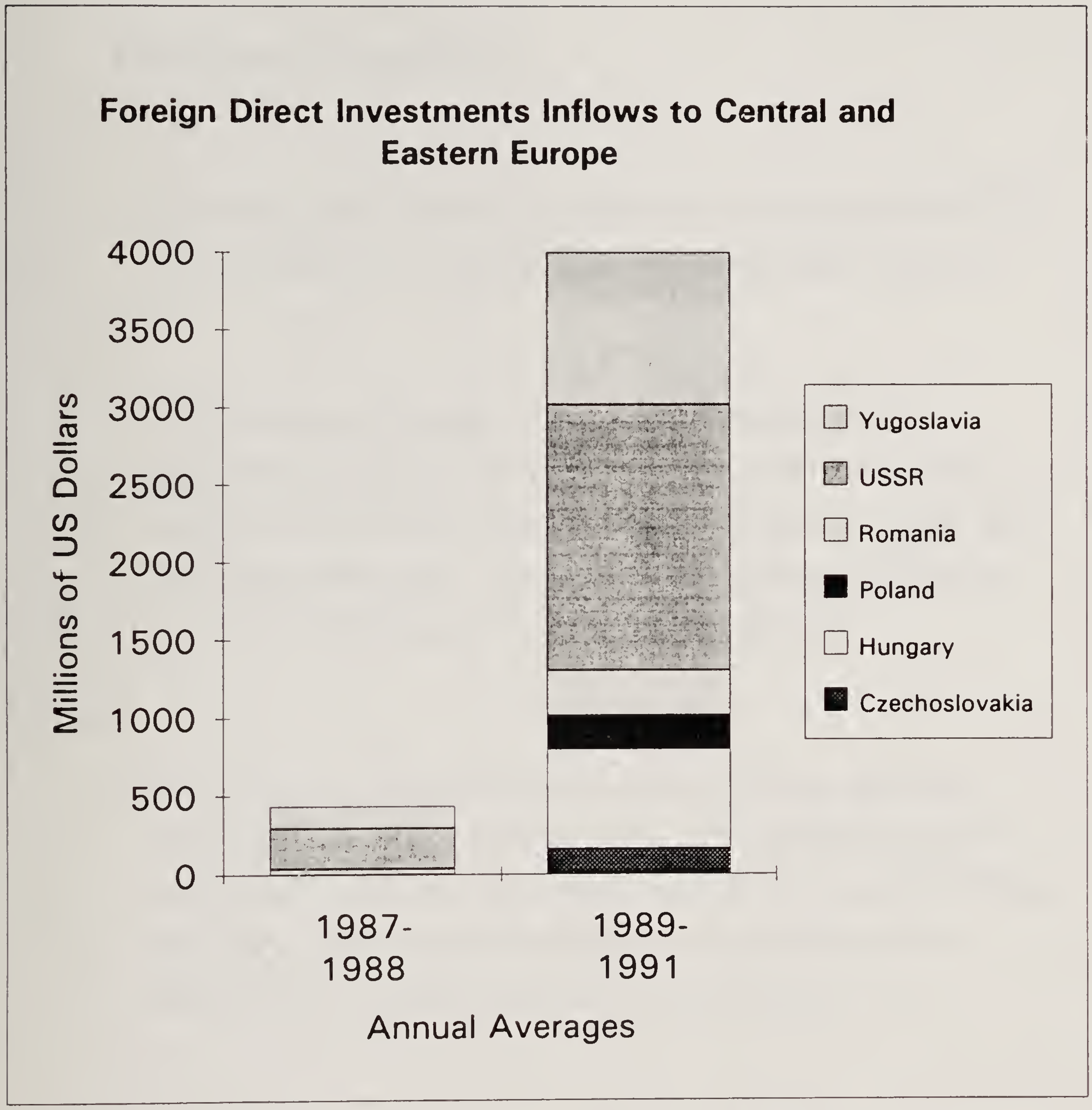


Source: UNCTAD. World Investment Report, 1993.

The largest recipient of FDI inflows was Mexico followed by China.



Source: World Investment Directory, Vol. II, Central and Eastern Europe, 1992.

According to the data from the OECD, by the end of 1992 the total capital commiment was $14 billion.

Regional Trends in Foreign Direct Investment

Developed Countries:

- Developed Countries continue to account for 97% of worldwide foreign direct investment outflow.

- Outflows of foreign direct investment from developed countries declined in 1991 and 1992 largely due to decline in outflows from Japan and Western Europe. However, the US increased its share of outflows over the same period.

- Investment inflows to the developed countries declined in 1991 and in 1992 due mainly to the decline in inflows into the US. However, the share of intra-regional investment in the European Economic Area continued to increase.

Regional Trends in Foreign Direct Investment

Developing Countries:

- There was a strong increase in foreign direct investment inflows to developing countries between 1984 and 1992, reaching $40 billion by 1992.

Asia-Pacific:
- FDI inflows increased due to strong economic growth in South-East Asia and China.
- China became the largest recipient of foreign direct investment in the region.
- Japan remains the major source of foreign direct investment inflows to the region.

Latin America:
- Strong increases in inflows since 1988.
- Inflows remain heavily concentrated in a handful of countries: Argentina, Brazil, Chile, Mexico and Venezuela.
- Mexico is the largest recipient of foreign direct investment among this group.

Regional Trends in Foreign Direct Investment

Central and Eastern Europe:

- Inflows of foreign direct investment into Central and Eastern Europe began in earnest between 1987-1988. From 1989-1991, inflows have intensified significantly.
- By the end of 1992, the number of FDI registrations reached 60,000, with $14 billion committed.
- The former USSR has been the recipient of the largest inflows closely followed by Hungary.

Factors Influencing the Pattern of Foreign Direct Investment Flows

Short Term Factors:

Flows of Foreign Direct Investment are strongly correlated with Growth in Gross Domestic Product.

Long Term Factors:

Policies:
The liberalization of trade and investment regimes worldwide, especially in developing economies.

The advent of privatization.

Structural Variables:
The development of economic blocs organized on a regional basis.

Sectoral Trends

Sectoral Trends and Definitions

The rapid growth of FDI has been accompanied by big changes in its sectoral composition. During the 1950's, FDI was concentrated in the primary sector and resource-based manufacturing; today, it is mainly in services and in technology-intensive manufacturing.

Definitions:

Primary Sector:

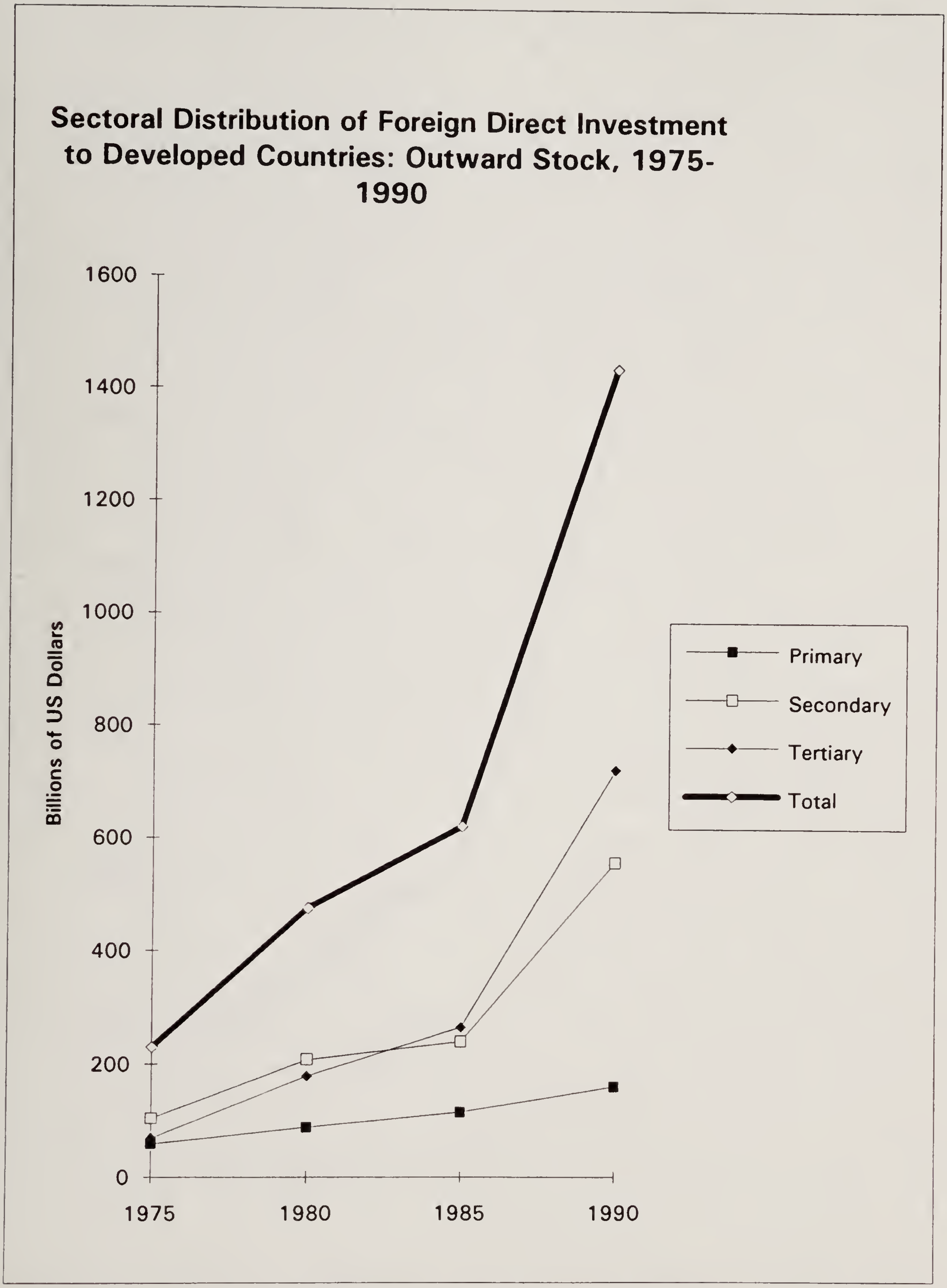
This sector comprises renewable resources (agriculture, fishing and forestry) and non-renewable (mining and quarrying and petroleum). Of the two, non-renewable resources dominate FDI.

Secondary Sector:

This is the manufacturing sector including capital- and technology-intensive industries and resource- and labour-intensive activities.

Tertiary Sector:

This sector includes all services.



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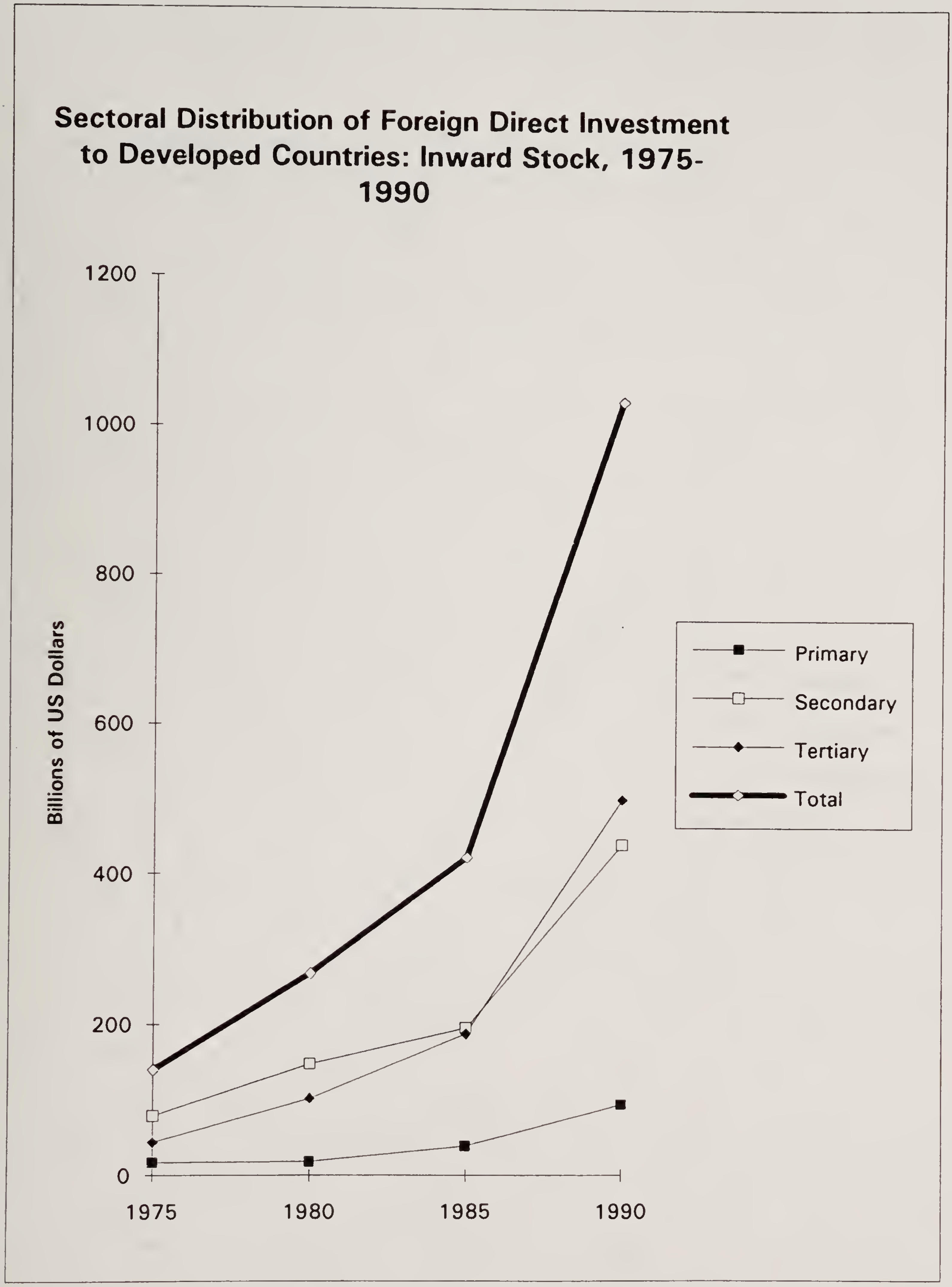

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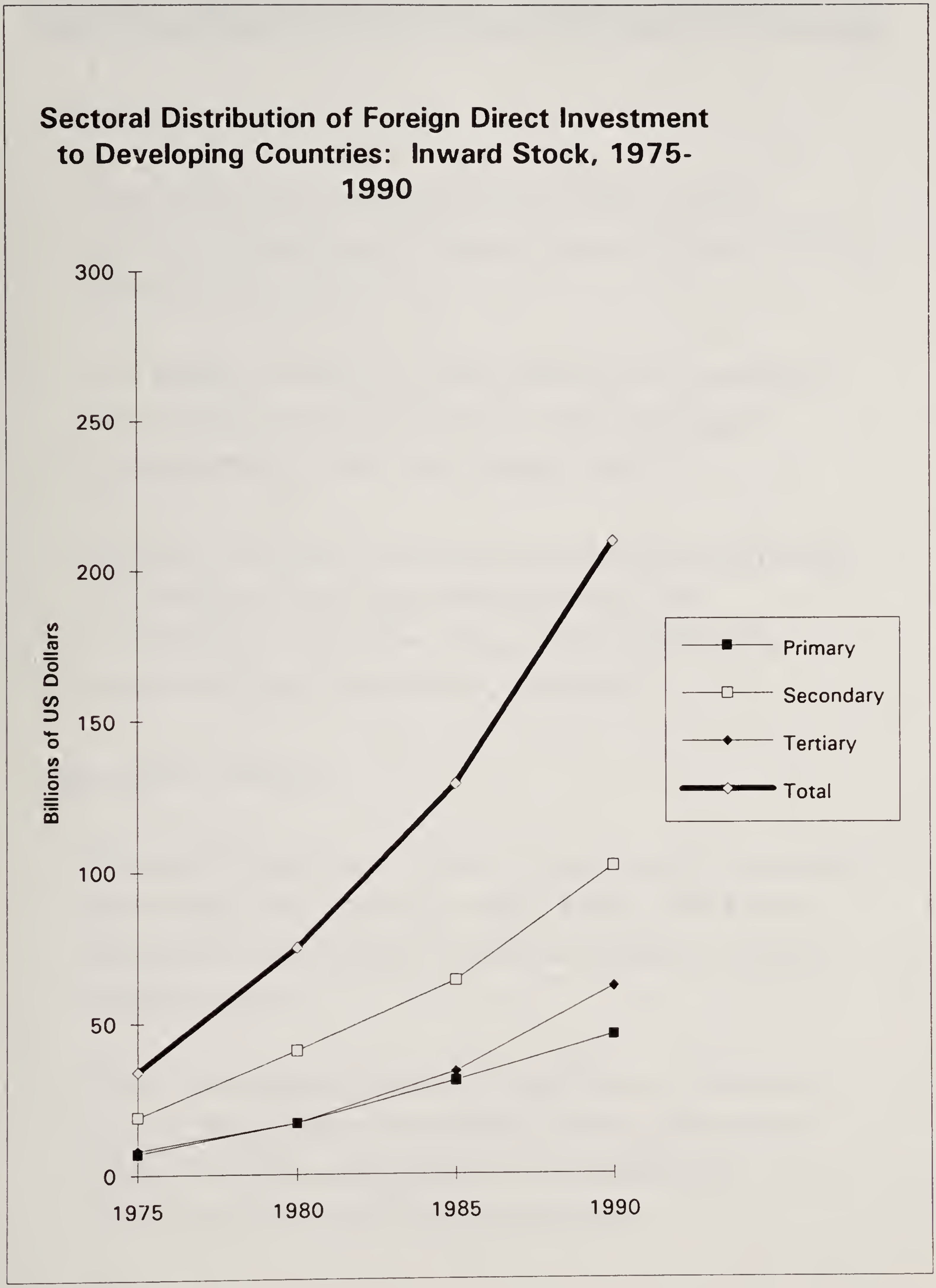


Source: UNCTAD, World Investment Report, 1993.

Sectoral Shifts in Foreign Direct Investment

Primary Sector:

- Proportion of investment flows in the primary sector declined from a high of about 25% in 1975 to about 11% by 1990.

- The relative decline in FDI inflows to the primary sector has been more drastic in the developed countries than in the developing regions.

- While the primary sector's inward stock continued to increase in both the developed and the developing economies, its growth significantly slowed through the last two decades.

Secondary Sector:

- The percentage share of investment in the secondary sector has risen since the mid 1980's. This has occurred at the expense of the investment into the primary sector.

- While the inward stock of investment continued to grow substantially in particular in the developed countries, their proportion of the total stock declined in the developed economies.

Sectoral Shifts in Foreign Direct Investment

- In both inward and outward FDI, there was a move to capital- and technology intensive industries, away from resource and labour-intensive activities.

- This trend toward more knowledge- and skill-intensive manufacturing appears to take place not only among broadly classified industries, but also within the same industries.

Tertiary Sector:

- Services have consumed an increasing share of foreign direct investment.

- Services have grown rapidly, particularly in the later part of the 1980's, in both outward and inward FDI of the developed countries and in inward FDI of several developing countries.

- Within the service sector, finance and trade-related activities account for two thirds of the FDI stock for developed countries, as well as, in many host developing countries.

- In the capital-intensive service industries-- telecommunications, transportation and public utilities-- FDI has so far been restricted in most countries.

Integration Strategies and Transnational Corporations

Transnational Corporations

Transnational Corporations (TNCs) are playing an extremely important role in the global economy. In 1990, over 170,000 foreign affiliates of some 37,000 parent firms generated approximately $5.5 trillion in worldwide sales. This compares with world exports of goods and non-factor services of $4 trillion, of which one third took the form of intra-firm trade.

TNC's total stock of global FDI was estimated to have reached $2 trillion in book value in 1992, which means that about one third on the world's private sector productive assets are under the governance of TNCs.

With this emergence of TNCs, there has been a move to integrating international production and to organize production on a regional or global basis.

Since most services are not tradeable, and must be consumed at the point where they are produced, the most common form of TNC strategy in the service sector is "stand-alone strategies."

In other sectors, TNCs have been adopting increasingly other forms of strategies such as "simple integration" and "complex integration."

Integration Strategies for Transnational Corporations

Stand-alone strategies

- Stand-alone affiliates or multi-domestic affiliates engage in international production while serving a single host country.

- The main link between a parent and its foreign affiliates is control though ownership.

Simple integration strategies

- As trade-barriers fall, affiliates or multi-domestic affiliates turn to outsourcing for parts of their value-adding operations.

- For some TNCs, their main involvement in international production is via outsourcing--some activities being performed in host countries and linked to work done elsewhere, mainly in the home country.

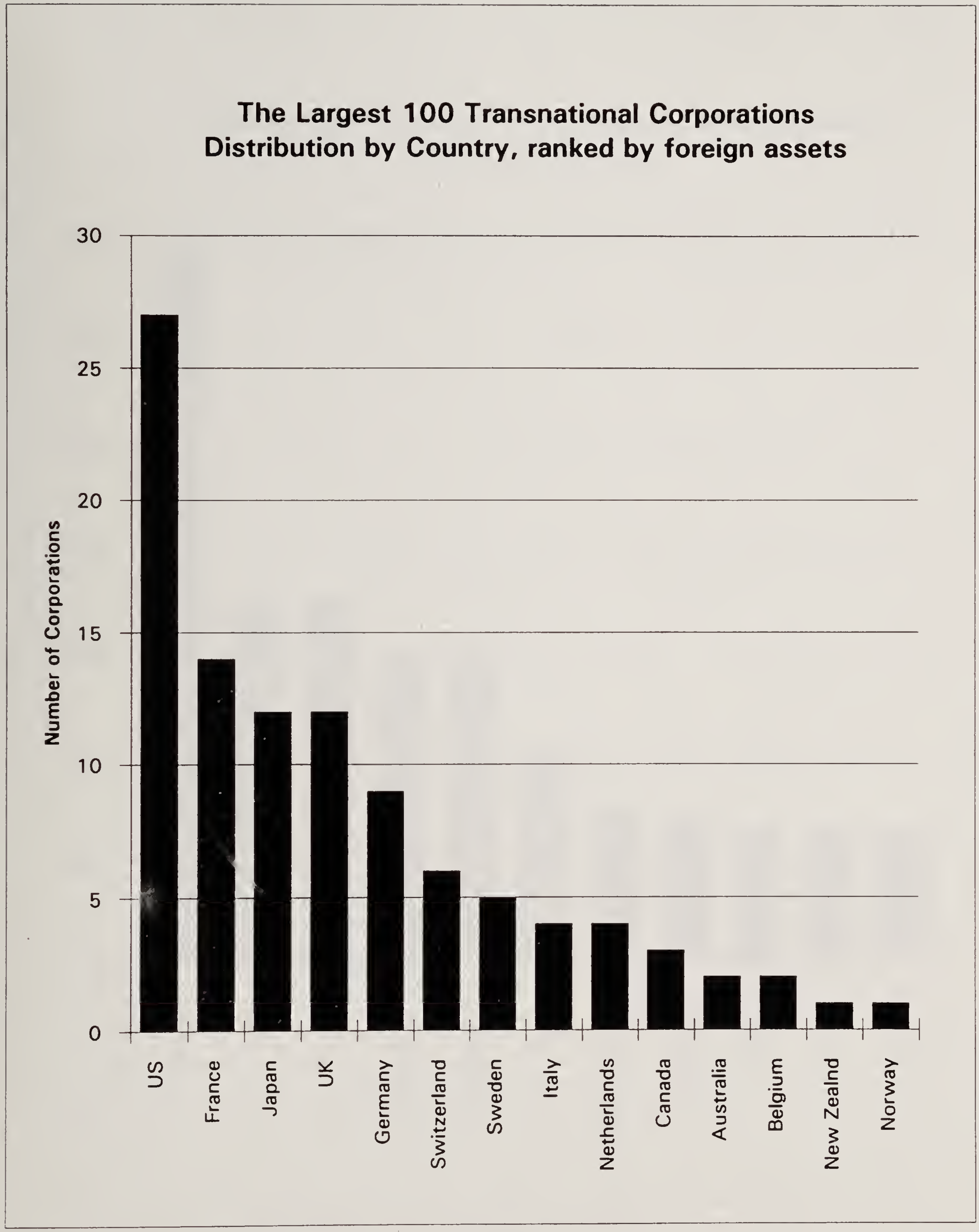
- Outsourcing is based largely upon the cost advantage of a particular economy.

Integration Strategies for Transnational Corporations

Complex integration strategies

- In recent years it has become clear that, for some firms, international production can occur at almost any point on the value chain.

- Complex integration strategy is based upon a firm's ability to shift production or supply to wherever it its most profitable. Under complex integration, any affiliate operating anywhere may perform, either by itself or with other affiliates of the parent firm, functions for the firm as a whole.



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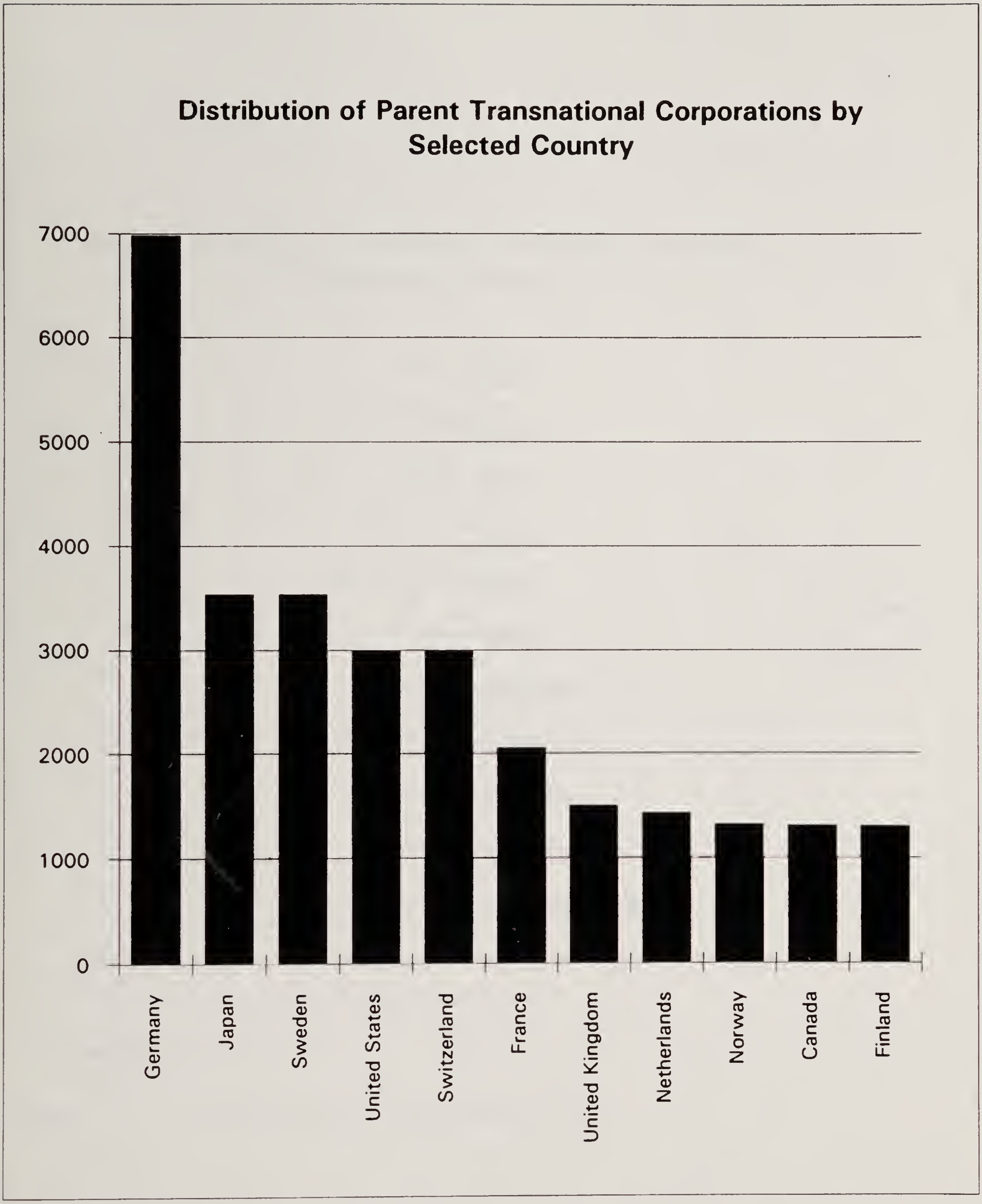

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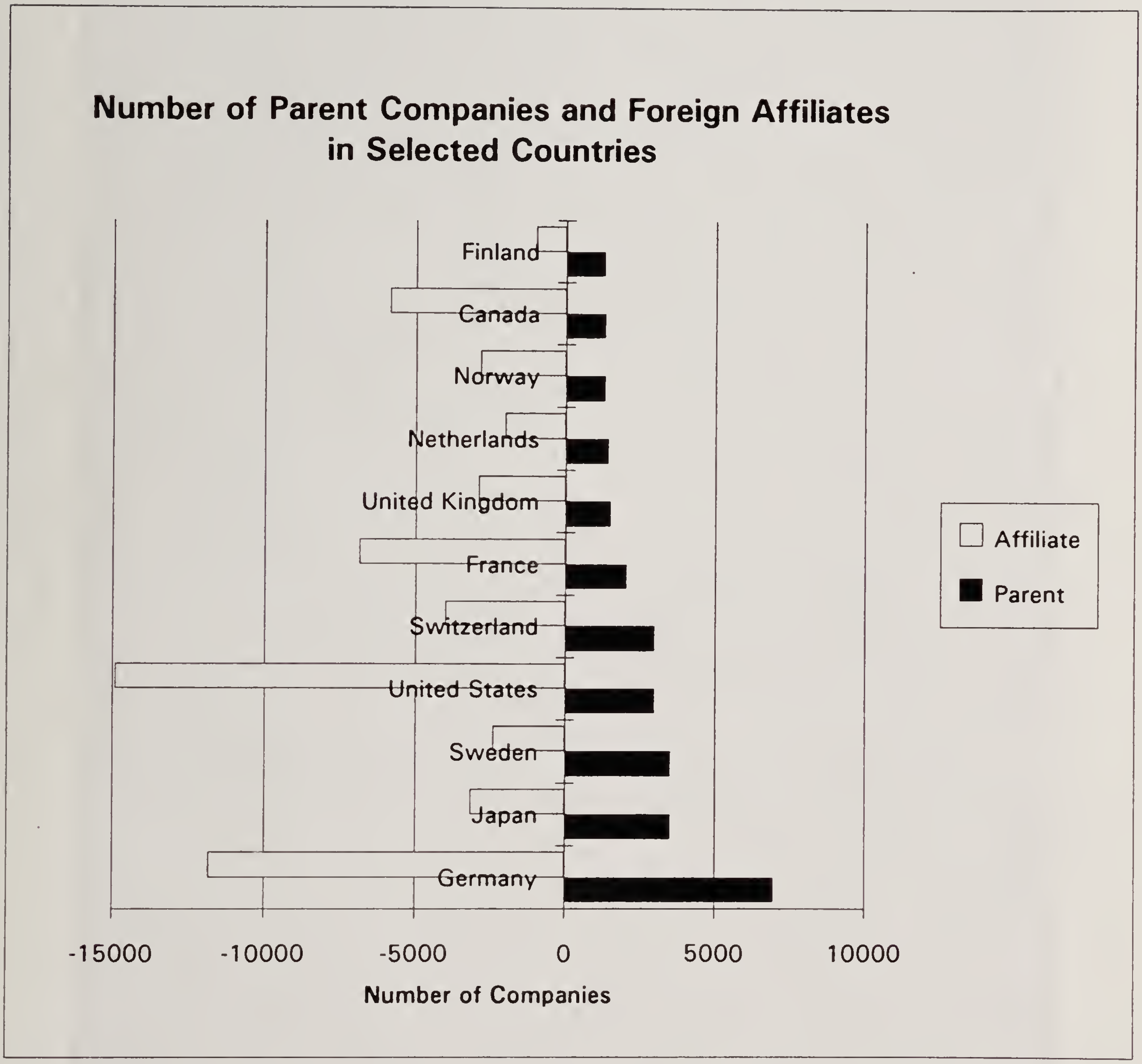
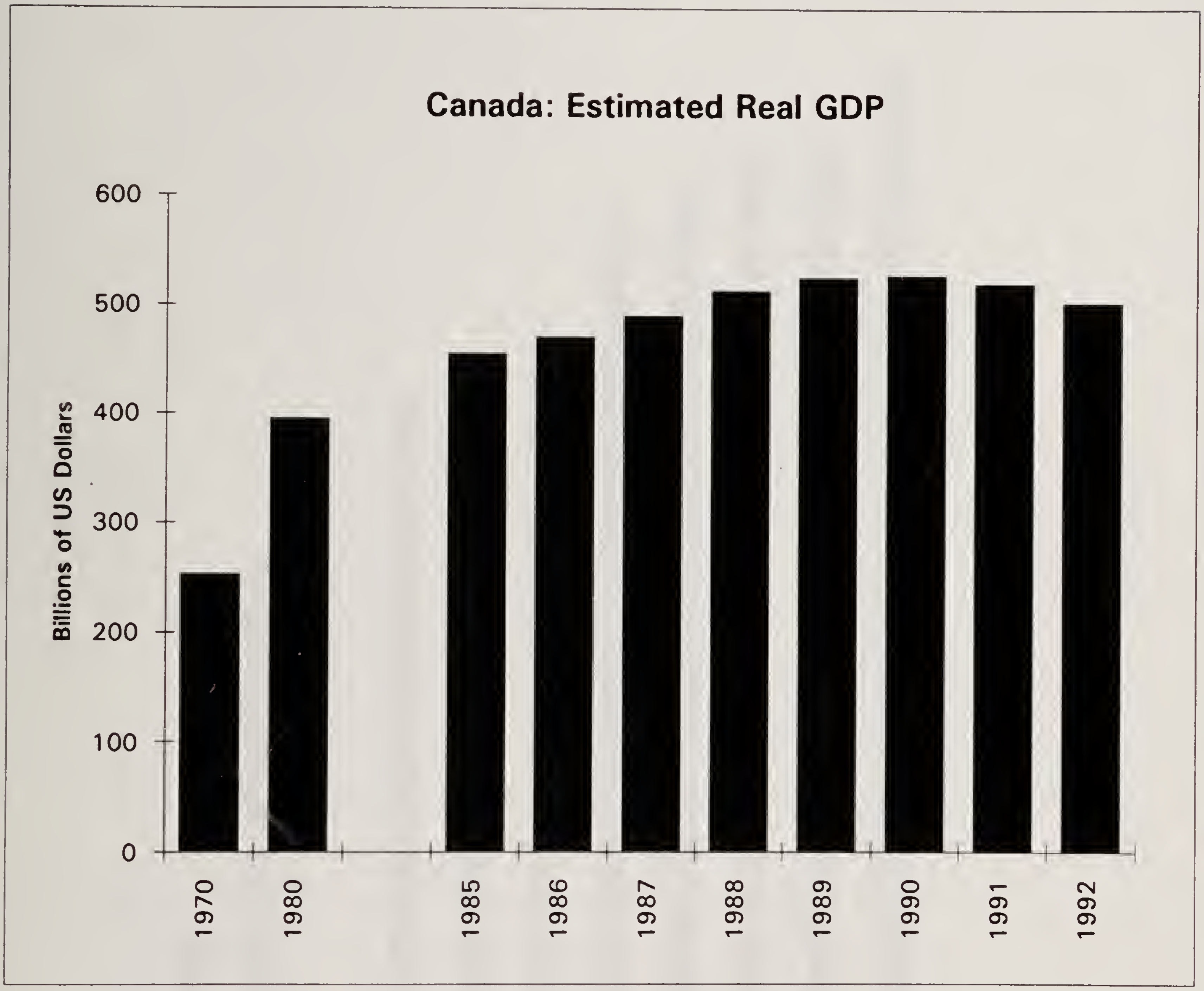
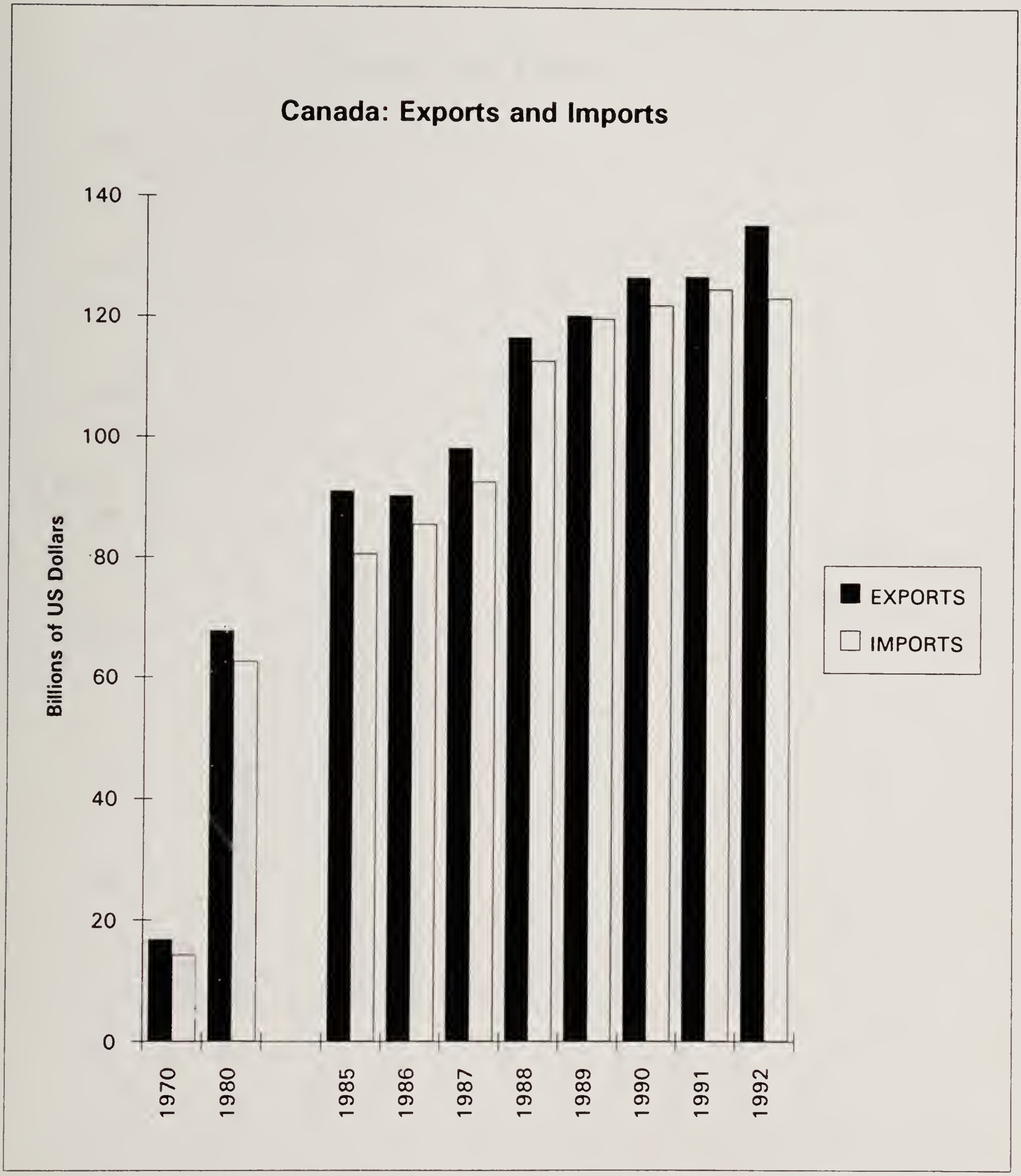


Source: UNCTAD. World Investment Report, 1993.

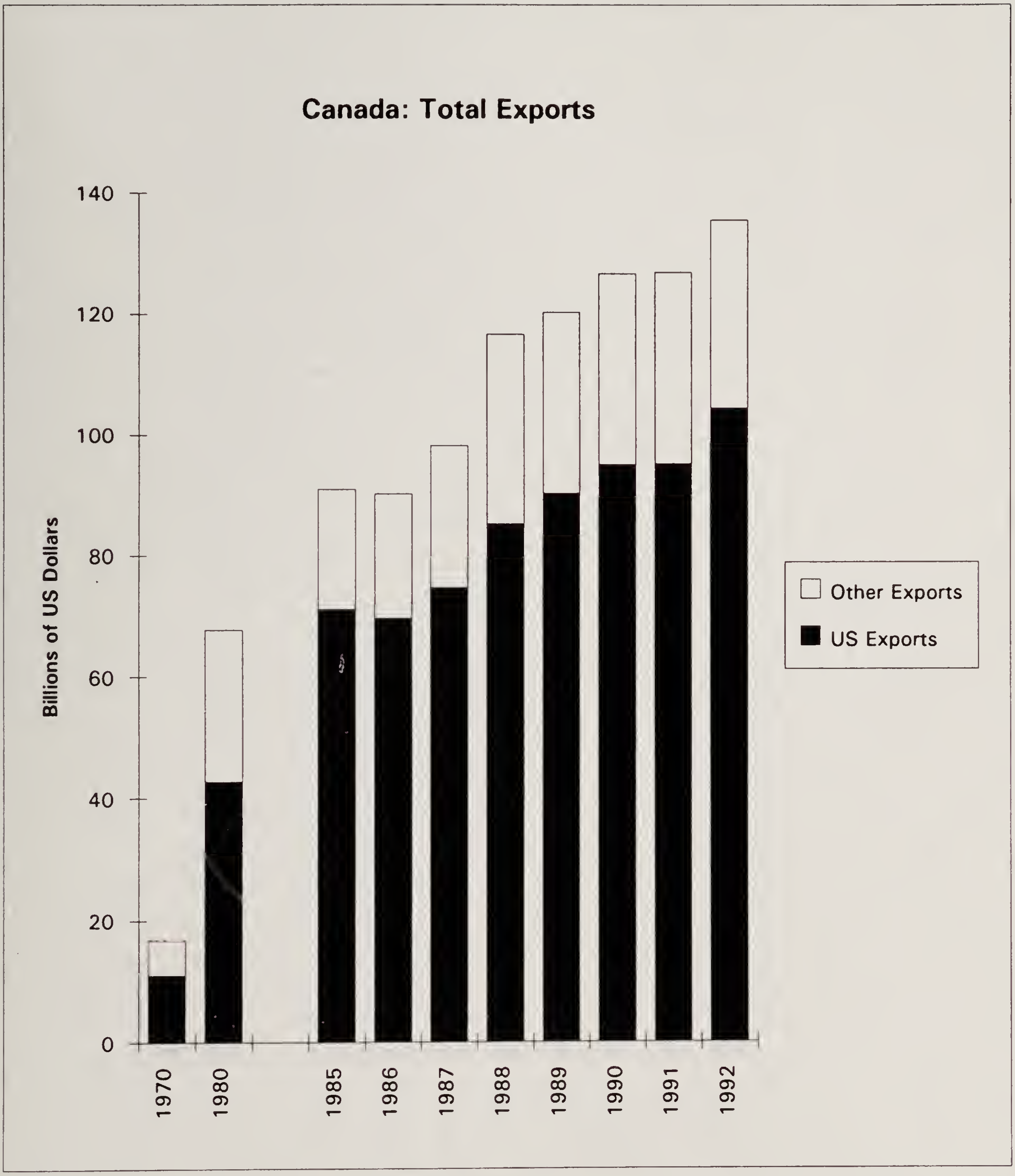
Implications for Canada: Conclusions and Recommendations



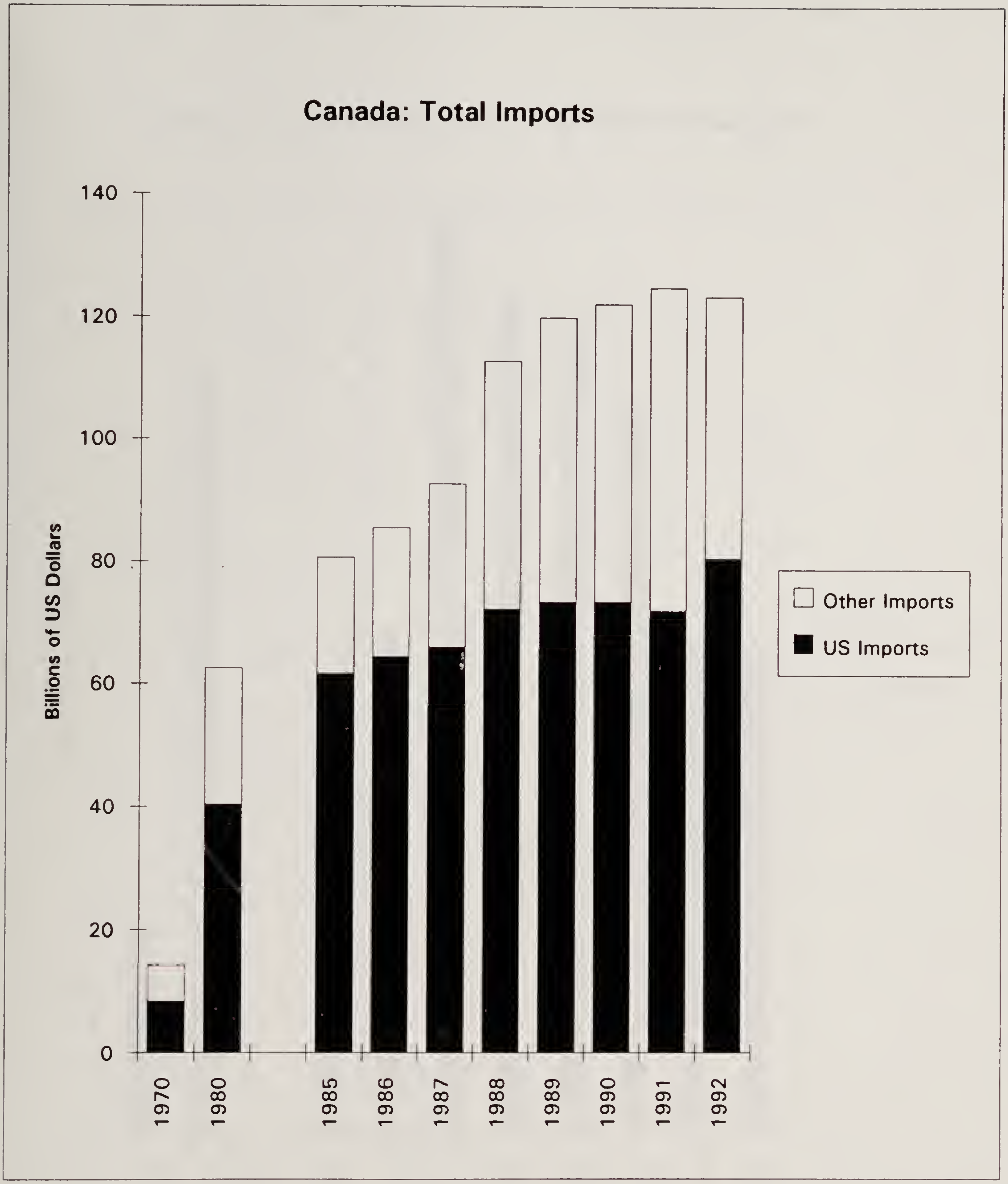
Source: Statistics Canada, Canadian Economic Observer 1992-3, Cat. 11-210



Source: CIA, Handbook of International Economic Statistics, 1992.

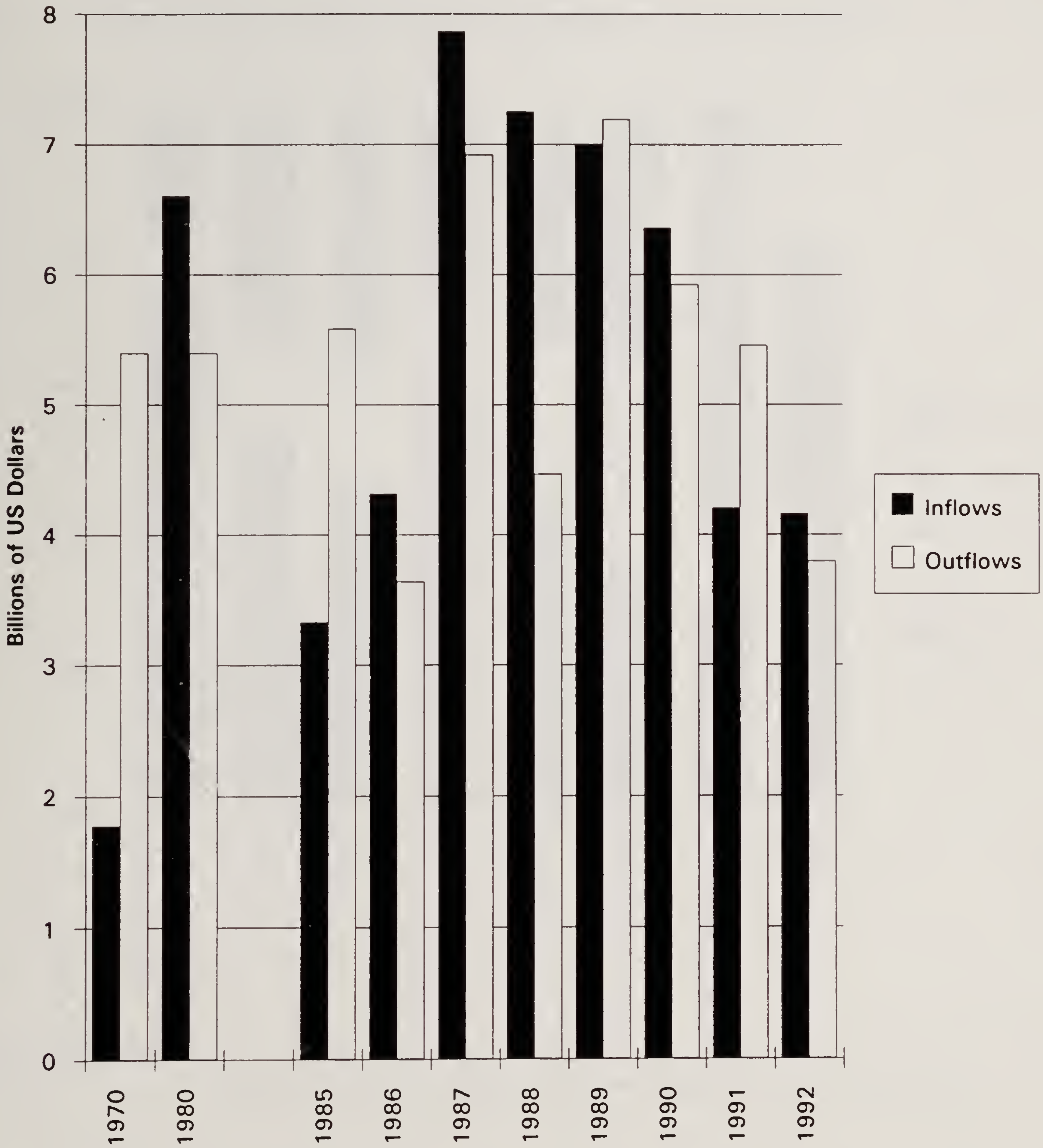


Source: CIA, Handbook of International Economic Statistics, 1992.

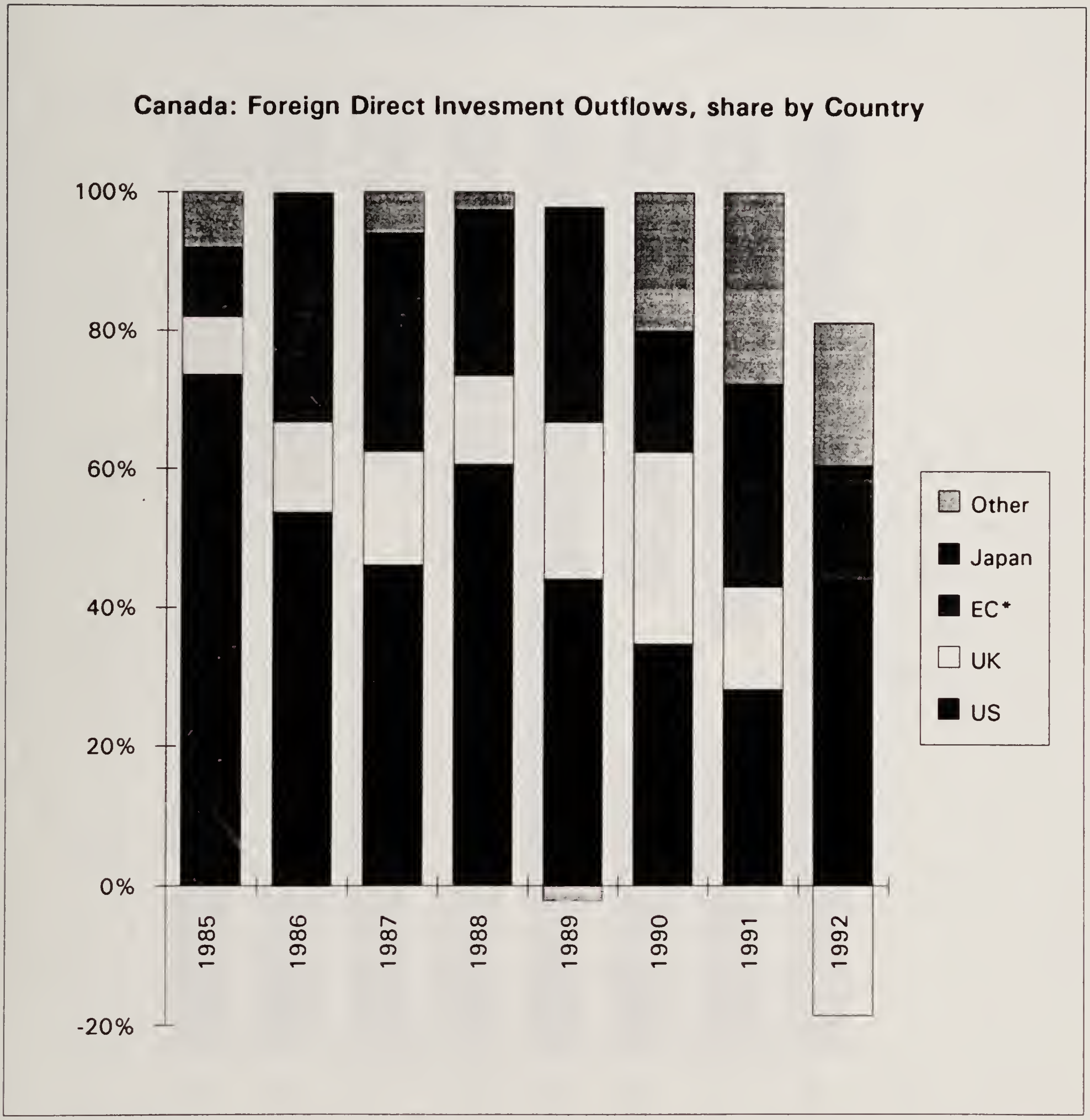


Source: CIA, Handbook of International Economic Statistics, 1992.

Canada: Inflows and Outflows of Foreign Direct Investment



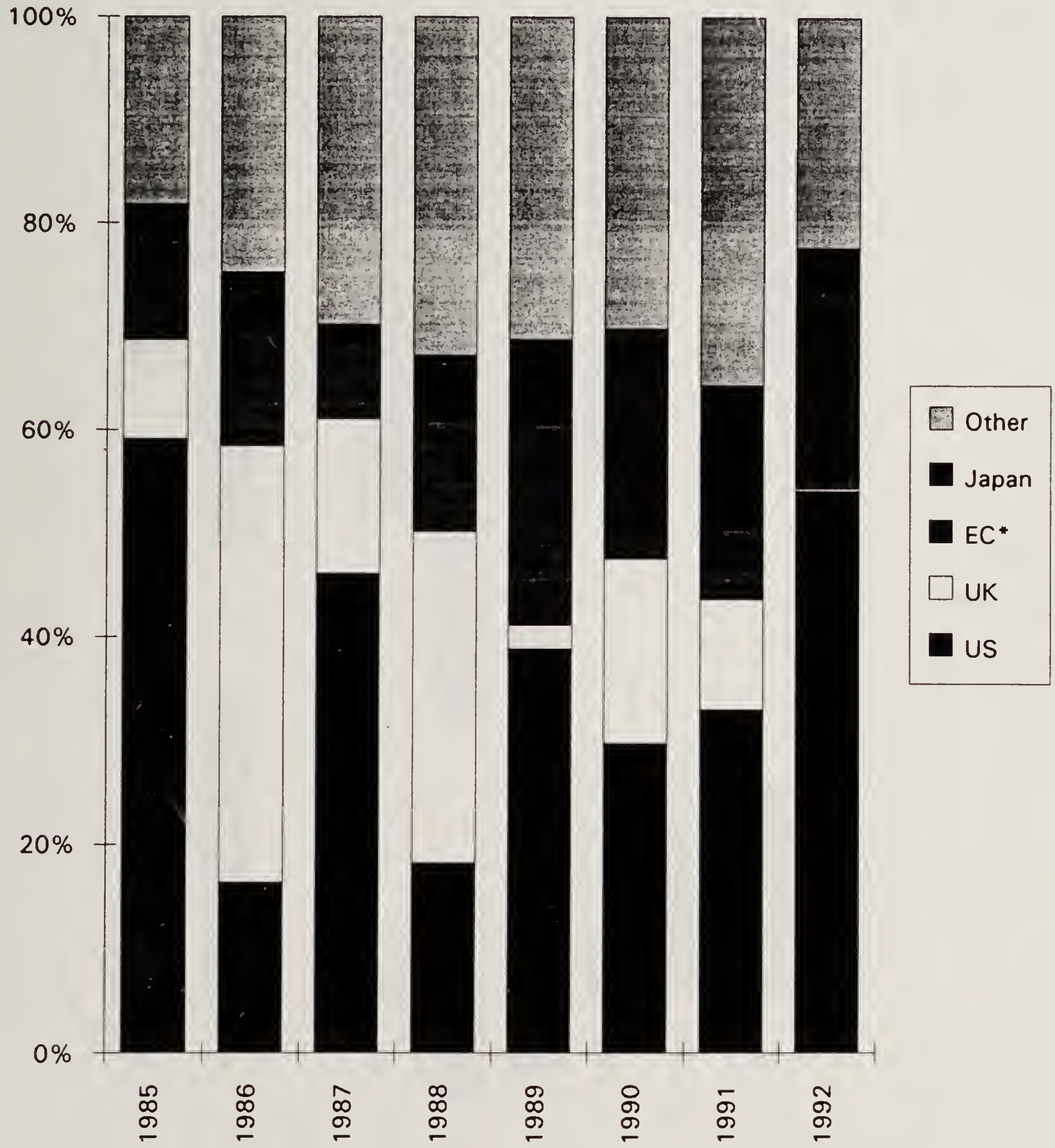
Source: Statistics Canada, Canada's International Investment Position, 1926-1992



* EC excludes UK

Source: Statistics Canada, Canada's International Investment Position, 1926-1992

Canada: Foreign Direct Investment Inflows, share by Country



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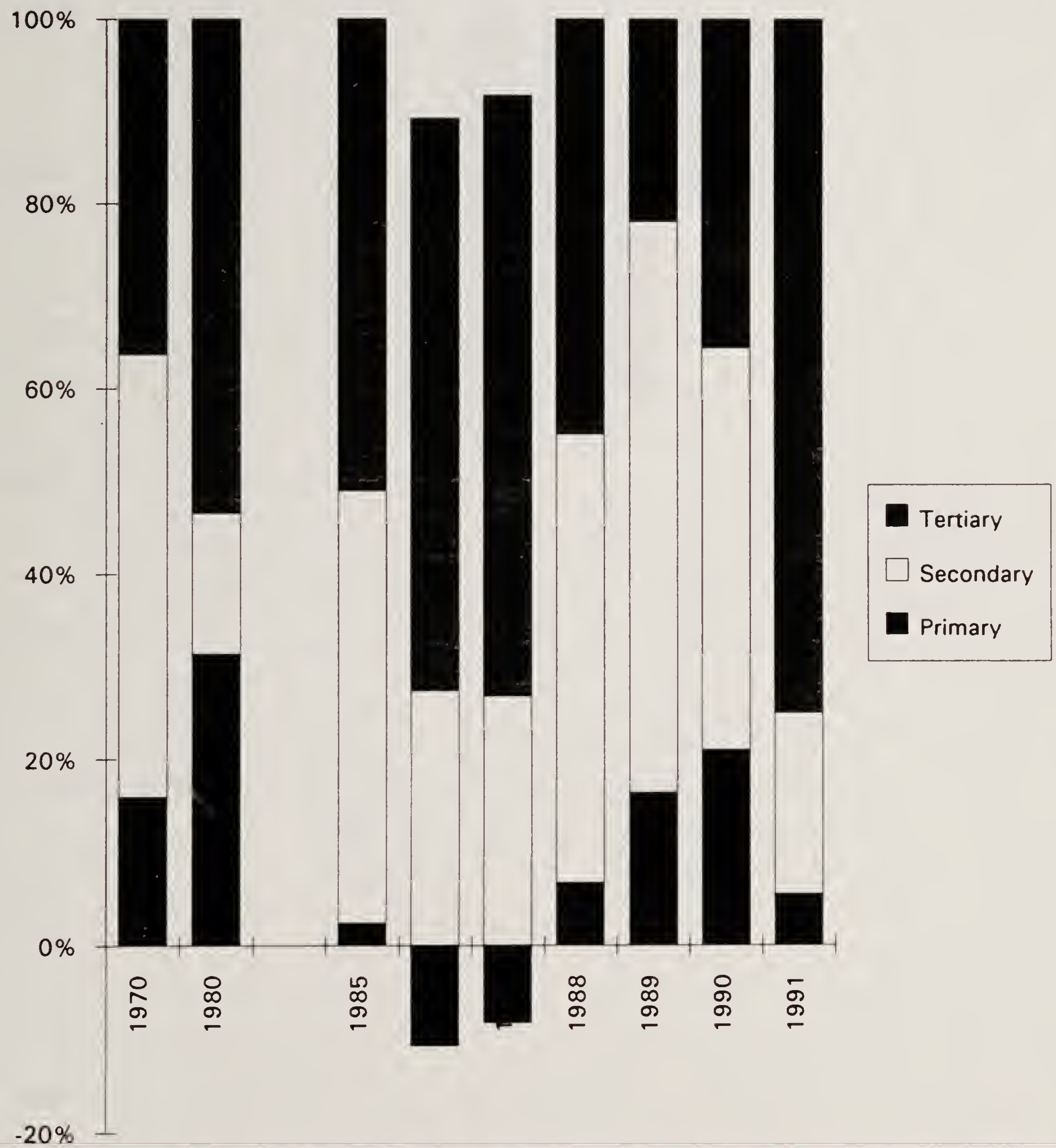
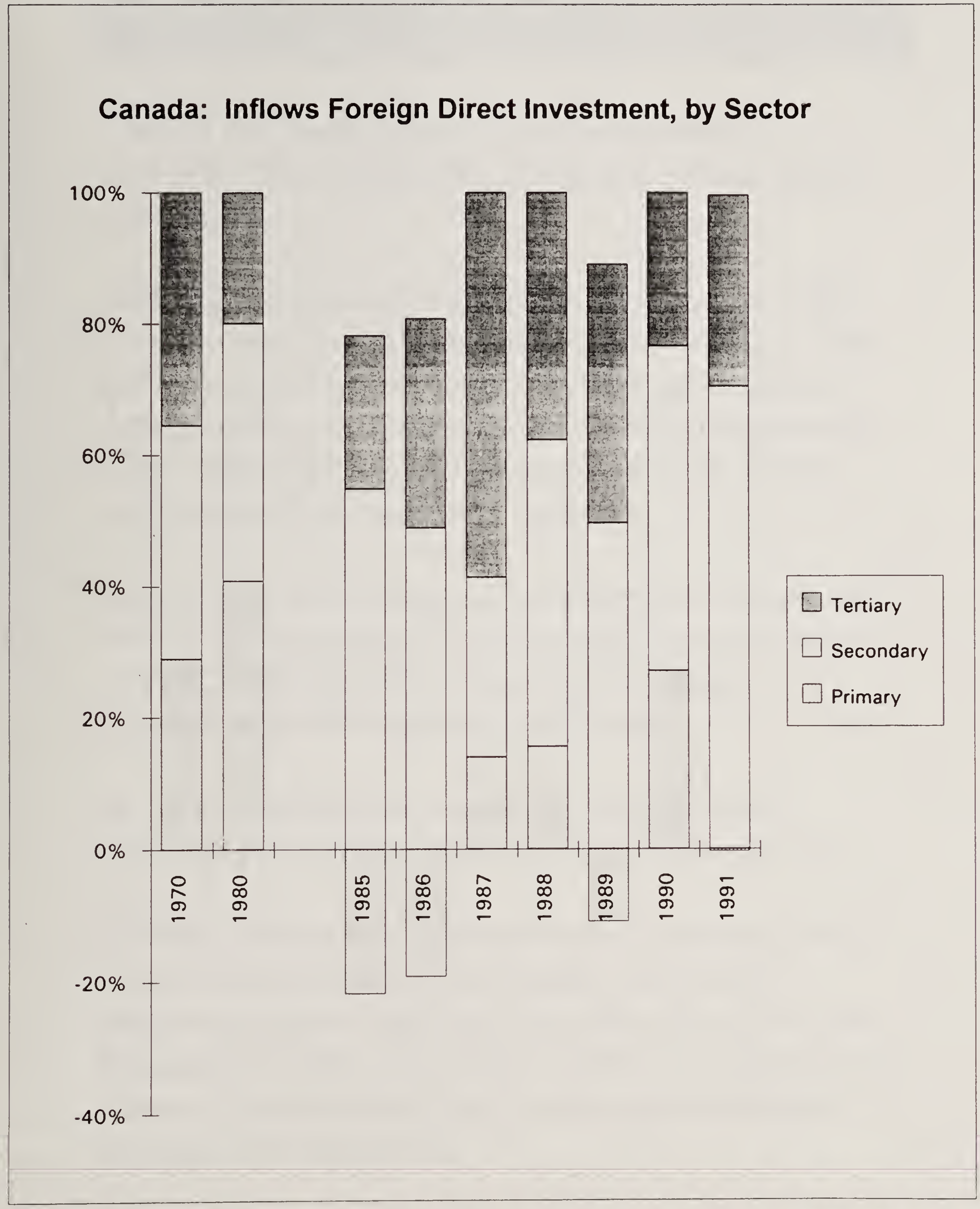
Canada: Outflows of Foreign Direct Investment, by Sector



Source: Statistics Canada, Canada's International Investment Position



Source: Statistics Canada, Canada's International Investment Position, 1926-1992

Conclusions

Canada has maintained its export orientation, however, it has lost its share of global foreign direct investment.

FDI inflows peaked in 1987. However, since 1988, foreign direct investment inflows have declined. The primary sector has received a decreasing amount of foreign direct investment inflows, turning negative in 1991, while inflows into the secondary and tertiary sectors have been relatively constant.

Foreign Direct Investment flows between Canada and the US have fluctuated over the years with an upturn in 1992, with the US accounting for a rising proportion of FDI inflows into Canada.

In terms of exports and imports, the trade level continued to increase between Canada and the US.

In 1991, there was a decline in inflows and outflows to and from Canada in the primary sector and a relative increase in inflows and outflows to and from the manufacturing and service sectors. In addition, the share of investment flows in each sector fluctuated between 1985 and 1991.

Conclusions

Canada has not been playing a prominent role as far as hosting parent TNCs either large or small.

On the other hand, there is a large number of affiliates hosted in Canada.

Thus, Canada has not really adjusted to the emerging new structure of the world economy. As a result, we have not been able to capitalize on growth opportunities in various parts of the world and our competitive strength appears to have been eroding.

Recommendations

Global Long-Term Scenario for Foreign Direct Investment

Foreign direct investments is projected to recover and surpass 1990 levels. One scenario indicates that by the year 2020 total FDI will reach $800 billion.

It is suggested that there will be a widening gap between returns to investment and growth in the developing and developed economies which means that:

- Developed countries will continue to decline unless structural changes in developing countries occur.

- There will be a major increase in FDI to the developing world from $40 billion in 1992 to $80 billion in the year 2000 and to nearly $400 billion by 2020 (which would represent half of the world total FDI).

- Structural change will continue in the form of liberalization of major service industries, precipitating the inflow of foreign direct investment. Services will be the fastest growing sector.

Recommendations for Canada

In light of the above scenario, to regain and strengthen Canada's competitiveness in the global market place it is recommended that serious efforts are made:

1) to internationalize firms based in Canada (both Canadian and foreign), and,

2) to support and nurture the formation of Canadian investment.